No. 14817

United States
Court of Appeals
for the Ninth Circuit

ROBERT RIDDELL, Collector of Internal Revenue, and HARRY C. WESTOVER, former Collector of Internal Revenue, Appellants,

vs.

EARL CALLAN and HELEN W. CALLAN, Appellees.

Transcript of Record

Appeal from the United States District Court for the Southern District of California, Central Division

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif. —10-3-55

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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For the Appellants.

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For the Appellees. [1*]

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* Page numbers appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States, Southern District of California, Central Division

No. 13922-WB

EARL CALLAN and HELEN W. CALLAN,
Plaintiffs,

vs.

ROBERT RIDDELL and HARRY C. WESTOVER,
Defendants.

COMPLAINT FOR RECOVERY

Come now the Plaintiffs and for their First Cause of Action against Defendants allege:

I.

That this is an action to recover income taxes erroneously, wrongfully, and illegally assessed and collected in excessive amount, together with interest thereon, and is instituted against defendants under the Revenue laws of the United States.

II.

That at all times herein mentioned, plaintiffs were, and now are residents of the City of Los Angeles, County of Los Angeles, State of California; that the said place of residence is in the Central Division of the United States District Court in and for the Southern District of California; that references to "plaintiff" (singular) in Paragraphs III to IX, both inclusive, of this complaint shall be deemed to refer to plaintiff Earl Callan. [2]

III.

That defendant, Harry C. Westover, was duly appointed as Collector of Internal Revenue for the Sixth District of California, on or about July 1, 1943, and at all times mentioned herein before and including October 31, 1949, was the duly acting and qualified Collector for said District; that at all times herein mentioned, the defendant, Harry C. Westover, resided and now resides in the Central Division of the Southern District of the above entitled Court.

IV.

That at all times herein mentioned, plaintiffs were on a calendar year basis for tax purposes.

V.

For more than one year prior to and on and after March 2, 1938, plaintiff was the sole owner of real estate commonly known as 1740 Riverside Drive, Los Angeles, California, and 1723 Rancho, Los Angeles, California, together with all improvements, fixtures and appurtenances to said real estate. Plaintiff's original cost for the land at 1740 Riverside Drive was the sum of $11,725.00 and his cost for the improvements, fixtures and appurtenances to the real estate at 1740 Riverside Drive was $57,-360.00. Plaintiff's total cost for said land and improvements, fixtures and appurtenances at 1740 Riverside Drive was therefore, $69,085.00.

Plaintiff owned furniture and furnishings which were located at 1740 Riverside Drive at the time of the flood hereinafter referred to. Plaintiff's cost for

said furniture and furnishings was $45,295.00. For income tax purposes, no depreciation deduction was allowed to plaintiff against said costs, and the amount of depreciation allowable against said costs was inconsequential.

In addition, plaintiff owned various personal clothing, personal jewelry, personal effects and other personal non-business property which was located primarily on the second floor of the [3] residence building at 1740 Riverside Drive. Plaintiff's cost for such clothing, jewelry, effects and other personal non-business property was at least $15,420.00.

Plaintiff's original cost for the land at 1723 Rancho was in excess of $7,000.00 and plaintiff's cost for sprinkler system, landscaping, driveway and patio improvements to said land was in excess of $1500.00. Plaintiff's cost for said land with said sprinklers, landscaping, driveway and patio was, therefore, in excess of $8500.00. Plaintiff's cost for the swimming pool, walls and buildings located on said real estate at 1723 Rancho, was at least $28,-050.00 and the amount of depreciation allowed and allowable against said swimming pool, walls and buildings was $4,290.00 for income tax purposes at the time of the flood hereinafter referred to. The total cost to plaintiff of said real estate at 1723 Rancho, net after subtracting for depreciation allowed and allowable, was, therefore, $32,260.00 at the time of the flood hereinafter referred to.

Plaintiff owned the following personal property at the following designated cost to him, which was

situated at 1723 Rancho at the time of the flood hereinafter referred to:

Item		Cost
Oriental rug	at least	$3,500.00
Domestic Rug	at least	75.00
Bar and mirror	at least	150.00
Eight (8) Spanish Posters	at least	800.00
Total	at least	$4,525.00

The fair market value of all and each and every one of the said assets described in this paragraph V, was at least as great as the respective cost to plaintiff alleged herein, net after subtraction for depreciation allowed or allowable, as herein alleged.

At all times material herein, commencing prior to the year 1938 and continuously thereafter without interruption to the present [4] time, plaintiff has been engaged in the business of constructing, furnishing, owning, operating and renting residential real estate. On or about March 2, 1938, the real estate of 1723 Rancho was being rented by the plaintiff in the course of such business to Ralph Bellamy, and the real estate at 1740 Riverside Drive was being temporarily occupied by the plaintiff in the course of such business for the purpose of completing the proper furnishing at 1740 Riverside Drive and to follow his continuous business practice over a period of years to occupy residences in order to more advantageously display such residences to prospective tenants or purchasers, and plaintiff was engaged in the course of such business in efforts to rent said real estate at 1740 Riverside Drive.

VI.

On or about the 2nd day of March, 1938, the Los Angeles River overflowed its banks and levees and its normal channel, suddenly, and caused a flood which inundated plaintiff's said real estate at 1723 Rancho and 1740 Riverside Drive and entirely washed away and destroyed all the plaintiff's said swimming pool, walls, buildings and other real estate improvements, furniture, furnishing, personal clothing, personal jewelry, personal effects and all other personal property at 1740 Riverside Drive and 1723 Rancho, and so damaged plaintiff's land at said locations that the aggregate value of said lands after said flood was only Four Thousand Dollars ($4000.00).

VII.

From and after the time of said flood and continuously thereafter during the year 1938, plaintiff strongly believed and was advised by his attorneys that he could obtain reimbursement for his loss by legal action against the Los Angeles County Flood Control District. Accordingly, on or about May 31, 1938, plaintiff filed a claim against and with said Los Angeles County Flood Control District in the amount of Two Hundred Twenty Thousand Seven Hundred Forty Dollars ($220,740.00), for the purpose of obtaining reimbursement [5] for his aforesaid damages, in addition to other damages sustained by him by reason of said flood. This claim was denied by the Los Angeles County Flood Control District in December 1938. Plaintiff thereupon

commenced and, continuously until the time of filing suit, prosecuted preparations and work for the purpose of filing suit for such reimbursement. Plaintiff filed suit in the Superior Court in and for the County of Los Angeles against said Los Angeles County Flood Control District in February, 1939, and continuously and diligently prosecuted the case thereafter. The case was tried before the jury of the Superior Court in and for the County of Los Angeles in the year 1946. The jury was instructed by the said Court to bring in a verdict for and amount which the jury found to represent the difference between the loss which would have occurred in the absence of negligence by the Los Angeles County Flood Control District, and the actual loss sustained. The jury brought back a verdict in favor of plaintiff in the amount of $80,000.00. Plaintiff made no motion for a new trial, nor did plaintiff attempt to secure any remedy other than judgment for the amount of said verdict. Plaintiff thereupon at that time, in the year 1946, abandoned all efforts to secure any recovery or reimbursement in excess of the sum of $80,000.00.

VIII.

Said Superior Court entered a judgment in favor of plaintiff Earl Callan in the amount of $80,000.00 on or about March 27, 1946. The defendant, Los Angeles County Flood Control District filed a motion for new trial which was granted by said Superior Court on or about May 16, 1946. Plaintiff Earl Callan in the year 1946 appealed from the said

order of the Superior Court to the California District Court of Appeals and the California District Court of Appeals affirmed said order for new trial on October 17, 1947, and on December 15, 1947 the Supreme Court of California refused to grant a hearing of plaintiff's appeal from the decision of said District Court of Appeals [6] and the case was remanded to the Superior Court in and for the County of Los Angeles for a new trial. In the year 1948, plaintiff executed an agreement of settlement and release with the Los Angeles Flood Control District. Plaintiff's net recovery in said settlement after attorneys' fees and court costs, was in the amount of $8403.05.

IX.

In the said trial, the jury's instructions were to grant plaintiff a verdict only for that portion of his damages which would have occurred in the absence of negligence on the part of the Los Angeles County Flood Control District. Plaintiff's personal clothing, personal jewelry, personal effects and other personal property cost him about $15,420.00 and were located primarily on the second floor of the residence building at 1740 Riverside Drive and could have been saved if the inundation on plaintiff's property had been less severe. Some part of the buildings and improvements at 1723 Rancho and 1740 Riverside Drive could have been salvaged if said flood had been less severe. The said verdict was for reimbursement to plaintiff for the following losses in the following amounts:

For personal clothing, personal jewelry, personal effects and other personal, non-business property at 1740 Riverside Drive	$15,420.00
For damages to real estate, improvements, buildings, fixtures, appurtenances, furniture and furnishings at 1723 Rancho and 1740 Riverside Drive	64,580.00
Total	$80,000.00

X.

That throughout the year 1948 and continuously thereafter at all times to and including March 6, 1952, plaintiff Helen W. Callan was and now is a resident of the City of Los Angeles, County of Los Angeles, State of California, and the wife of plaintiff Earl Callan; that the said place of residence is in the Central Division of the United States District Court in and for the Southern District of [7] California.

That defendant Robert Riddell was duly appointed and acting as Acting Collector of Internal Revenue for the Sixth District of California from November 1, 1949, to April 30, 1950, both inclusive, and was duly appointed as Collector of Internal Revenue for the Sixth District of California on or about May 1, 1950, and at all times subsequent thereto and continuing to the date of filing this complaint has been the duly acting and qualified Collector for said district; that at all times herein mentioned the defendant, Robert Riddell, resided and now resides in the Central Division of the Southern District of the above entitled Court.

XI.

On or before March 15, 1949, plaintiffs filed their joint income tax return with the defendant Harry C. Westover, as Collector of Internal Revenue for the Sixth District of California, for the calendar year 1948, setting forth a net loss of at least $23,-986.81, and reporting upon said return a net tax liability of zero. Plaintiffs paid no income tax for the year 1948 at the time of filing said return.

XII

Plaintiffs' 1948 income tax return computed the net loss of $23,986.81 by reporting a deduction from plaintiffs' other 1948 income of a loss of $71,596.95. Said $71,596.95 represents the difference between the $80,000.00 jury verdict and judgment rendered in the year 1946, and the $8,403.05 net recovery in 1948. Plaintiffs' 1948 income tax return claimed no deduction for the balance of plaintiff Earl Callan's loss. Said balance of loss is the difference between the amount of the total flood damage and the $80,000.00 verdict.

XIII.

The deduction of $71,596.95 reported on plaintiffs' 1948 income tax return was properly allocated upon said return as a loss [8] attributable to business property in the amount of $57,796.64 and a loss attributable to personal effects in the amount of $13,800.31.

XIV.

On or about October 10, 1950, the Internal Revenue Agent in Charge for the Los Angeles Division

issued his report of examination of plaintiffs' 1948 joint income tax return, claiming additional 1948 tax liability from plaintiffs in the principal amount of $16,043.95. Said report erroneously and illegally adjusted plaintiffs' 1948 net income from a net loss of $23,986.81 to a net income of $49,621.83 by erroneously and illegally disallowing said deductions of $71,596.95 together with corollary adjustments. Pursuant to this report, in or about December, 1950, defendant Robert Riddell, Collector of Internal Revenue for the Sixth District of California, wrongfully, illegally and erroneously assessed against plaintiffs an income tax deficiency for the year 1948 in a principal amount of $16,043.95 together with interest in the amount of $2593.41, or a total of $18,637.36. On or about February 5, 1951, plaintiffs paid, under protest, said $18,637.36 to defendant Robert Riddell.

XV.

The true income tax liability of plaintiffs for the year 1948 was zero.

XVI.

The income tax and interest assessed against plaintiffs and paid by them, as aforesaid, in the sum of $18,637.36 was excessive and incorrectly computed and erroneously assessed, collected and retained by defendants and plaintiffs' net loss was incorrectly computed and incorrectly computed as net income by defendants and the Internal Revenue Agent in Charge for Los Angeles and the Commissioner of Internal Revenue, in the following particulars: [9]

A. Plaintiffs' Primary Position:

Plaintiffs' primary position is that in 1946, at the time of rendition of jury verdict and judgment for $80,000.00 plaintiff Earl Callan abandoned all efforts to secure any recovery or reimbursement in excess of the sum of $80,000.00 and thereupon, in 1946 finally sustained all of his damages and losses from said flood for income tax purposes, except the $80,000.00 represented by the verdict and judgment, against the Los Angeles County Flood Control District. Under this position, plaintiff Earl Callan sustained a loss in 1946 of $82,585.00 and in 1948 sustained a loss of $71,596.95 from said flood, computed as follows:

Item		Amount
1740 Riverside Drive—land		$ 11,725.00
1740 Riverside Drive—buildings, improvements, fixtures and appurtenances		57,360.00
1740 Riverside Drive—furniture and furnishings		42,295.00
1723 Rancho—land		8,500.00
1723 Rancho—House, stable, pools and dressing rooms		28,050.00
1723 Rancho—furnishings and posters		4,525.00
Total		$155,455.00
Less: Depreciation allowed and allowable on buildings and improvements at 1723 Rancho		$ 4,290.00
Adjusted cost basis of business assets immediately prior to 1938 flood		$151,165.00
Less: Fair market value of real estate at 1723 Rancho and 1740 Riverside Drive immediately after said flood	$4000	
Reimbursement for above assets represented by 1946 jury verdict ($80,000 verdict minus $15,420 for personal non-business items)	64580	68.580.00
Net amount of loss deductible in 1946 for income tax purposes		$ 82,585.00

1948 Loss

Total Net Amount $71,596.95

Net business loss and casualty loss on personal effects upon settlement of verdict.

Total amount of verdict	$ 80,000.00	
Recovered upon final settlement	8,403.05	
Percentage recovered	10.5038%	
Original verdict	$ 80,000.00	
Business portion	$64,580.00	
Personal effects	15,420.00	
Total	80,000.00	
Application of recovery percentage		
Business loss:		
Business portion of verdict	$ 64,580.00	
Amount recovered on settlement (10.5038%)	6,783.36	
Net business loss		$ 57,796.64
Personal effects loss		
Personal effects portion of verdict	15,420.00	
Amount recovered on settlement (10.5038%)	1,619.69	
Net loss on personal effects		13,800.31
Recapitulation		
Recovery: business	$6,783.36	
personal effects	1,619.69	
Total recovery		8,403.05

Net losses		
Business	$ 57,796.64	
Personal effects	13,800.31	
Total net loss		71,596.95
Amount of verdict		$ 80,000.00

Because the losses for the year 1948 as set forth above should have been allowed and subtracted, in accordance with law, plaintiffs' correct net income under the primary position is a net loss of at least $23,986.81 as correctly set forth upon the 1948 joint income tax return of Earl Callan and Helen W. Callan. [11]

The report of October 10, 1950 by the Internal Revenue Agent in Charge of the Los Angeles Division therefore erroneously, illegally and improperly disallowed and failed to subtract the following deductions in computing taxpayer's 1948 net income:

Loss attributable to business property	$ 57,796.64
Loss attributable to personal effects	13,806.31
Total	$ 71,596.95

B. Plaintiffs' Secondary Position:

Plaintiffs' secondary and alternative position is that for income tax purposes his loss from the March 2, 1938 flood was finally and entirely sustained by him in the year 1948 to the extent of the entire amount of such loss.

Under this position, the amount of plaintiffs' net loss in 1948 was at least $91,051.81 and the net operating loss in 1948 was at least $83,259.02, computed as follows:

Total adjusted cost basis of assets located at 1723 Rancho and 1740 Riverside Drive per subparagraph A of this paragraph XVI		$151,165.00
Less: fair market value of real estate at 1723 Rancho and 1740 Riverside Drive immediately after flood		4,000.00
Amount of loss		$147,105.00
Less: amount received in final settlement net after attorney's fees in costs in 1948		8,403.05
Net amount of loss in 1948 after reimbursement to extent of settlement proceeds		$138,661.95
Less: loss already deducted on 1948 income tax return as filed:		
Personal effects	$ 13,800.31	
Business loss	57,796.64	71,596.95
Loss under this alternative position to be added to loss per tax return for 1948		$ 67,065.00
Net loss per 1948 income tax return as filed		23,986.81
1948 net loss under this alternative position		$ 91,051.81
Less: Adjustment under Section 122(d), IRC to take long term capital gains into account at 100% instead of 50%		$ 7,792.79
Net operating loss in 1948		$ 83,259.02

The report of the Internal Revenue Agent in Charge of the Los Angeles Division therefore erroneously, illegally and improperly disallowed and failed to subtract losses for 1948 in the amount of $138,661.95 in computing plaintiffs' 1948 net income.

C. Substantive Legal Grounds:

Under both the primary and secondary positions of plaintiffs the losses in the respective amounts in-

dicated are deductible in 1948 on the following grounds:

The loss attributable to the business property at 1723 Rancho and 1740 Riverside Drive is a loss sustained in 1948:

(a) incurred in trade or business under Section 23(e)(1), Internal Revenue Code;

(b) Alternately, as a loss sustained in a transaction entered into for profit though not connected with the trade or business, under Section 23(e)(2), Internal Revenue Code;

(c) Alternatively, as a loss from storm or casualty of property not connected with the trade or business, not reimbursed by insurance or otherwise under Section 23(e)(3), Internal Revenue Code;

(d) Alternatively, as a loss from the involuntary conversion of real and depreciable property used in trade or business, under the provisions of sections 22(f), 113(a)(9), 111, 113(b) and 117(j) of the Internal Revenue Code.

The loss attributable to the personal effects is claimed as a loss sustained in 1948 as a loss of property not connected with the trade or business from storm or casualty, not reimbursed by insurance or otherwise under Section 23(e)(3), Internal Revenue Code. [13]

XVII.

On or about August 14, 1951, plaintiffs duly filed with the Collector of Internal Revenue for the Sixth District of California, defendant Robert Riddell, a claim for refund in the amount of $18,637.36 or such greater amount as is legally refund-

able, plus interest prescribed by law, with schedules attached and incorporated in said claim, setting forth the correct tax liability as zero, and setting forth as their grounds substantially the same grounds as are set forth in this complaint.

XVIII.

That more than six months has elapsed since the filing of said refund claim, and defendant Robert Riddell has failed and refused to allow said refund claim or any part thereof, and the Commissioner of Internal Revenue has neither allowed nor disallowed said claim.

XIX.

That defendant Robert Riddell has wrongfully, illegally and erroneously failed and refused, and still fails and refuses to refund to plaintiffs the sum demanded in the aforesaid claim, or any portion thereof, and that there is now due, owing and unpaid from said defendant to plaintiffs the aforesaid sum of $18,637.36 together with interest thereon from February 5, 1951, as prescribed by law.

For a further, separate and second cause of action against defendants, plaintiffs allege:

I.

Plaintiffs repeat and replead each and every allegation contained in Paragraphs I to XVI, both inclusive, of plaintiffs' First Cause of Action as though the same were herein set forth at length, but

excluding subparagraphs C(b) and C(c) of Paragraph XVI. [14]

II.

That on or before March 15, 1950, plaintiffs filed with defendant Robert Riddell as Collector of Internal Revenue for the Sixth District of California, their joint income tax return for the calendar year 1949; that plaintiffs in said return reported a joint net taxable income of $35,721.46 and a joint net tax liability of $9,429.46. Plaintiffs duly paid said tax liability of $9,429.46 in full on or before the 15th day of March, 1950, to the defendant Robert Riddell.

III.

On or about May 9, 1951, the Internal Revenue Agent in Charge for the Los Angeles Division issued his report of examination of plaintiffs' 1949 joint income tax return. Said report adjusted plaintiffs' net income by an increase of $2,529.02 for additional income from rental operations, and by a decrease of $1,000 for that portion of plaintiffs' $4,974.67 loss in 1949 from liquidation of Wolverine stock, which is deductible in 1949. That the Internal Revenue Agent in Charge reported that plaintiffs' joint net income for 1949 was $37,250.48, and claimed additional 1949 tax liability from plaintiffs in the principal amount of $654.74. Pursuant to this report, defendant Robert Riddell, Collector of Internal Revenue for the Sixth District of California, wrongfully, illegally and erroneously assessed against plaintiffs an income tax deficiency for the year 1949 in a principal amount of $654.74,

together with interest of $46.20, or a total of $700.94. Plaintiffs paid said $700.94 to defendant Robert Riddell on or about July 2, 1951.

IV.

That plaintiffs' joint 1949 income tax return and the said report of the Internal Revenue Agent in Charge both erroneously overstated plaintiffs' net income, in that both erroneously and improperly failed to deduct the amount of plaintiffs' net operating loss deduction allowable as a carry forward from the year 1948. [15]

That plaintiffs' net loss for the year 1948 is described in paragraph XVI in plaintiffs' first cause of action and incorporated in paragraph I of this cause of action, and was entirely a net operating loss for the year 1948 within the meaning of Section 122 of the Internal Revenue Code, except for the technical adjustments set forth in the next paragraph of this complaint.

V.

That pursuant to the allegations as herein set forth, there has been erroneously assessed against plaintiffs and erroneously claimed and retained from plaintiffs by defendant Robert Riddell, and plaintiffs have therefore overpaid their principal income tax liability for the year 1949 in the principal sum of either $1,287.80 under plaintiffs' primary position, or $5,905.00 under plaintiffs' secondary position. Plaintiffs' primary position and secondary position are as follows:

A. Plaintiffs' Primary Position:

Plaintiffs' primary position is that for income tax purposes, Earl Callan's loss from the March 2, 1938 flood was finally sustained by him in the year 1946 to the extent of the entire amount thereof except $80,000.00, which was the amount of the jury verdict and judgment granted to him in 1946.

The entire amount of the loss sustained in the year 1946, under plaintiffs' primary position, should properly be deducted from the income of years prior to 1949.

Under plaintiffs' primary position, the amount of plaintiffs' net operating loss carry-over deduction from 1948 in 1949 is at least $2,901.86 computed as follows:

1948 net loss per joint income tax return, as filed, of Earl and Helen Callan	$	23,986.81
Less: Adjustment under Section 122(d), I.R.C. to take long term capital gains into account at 100% instead of 50%		7,792.79
Net Operating loss in 1948	$	16,194.02
Less: Amount carried back to 1947		12,292.16
	$	3,901.86
(Other technical adjustments required under Section 122, I.R.C.) 1949 Capital Loss disallowed		1,000.00
Net Operating loss carry-over deduction from 1948 in 1949	$	2,901.86

Therefore, under plaintiffs' primary position, the total principal amount of income tax refund due plaintiffs is at least $1,287.80, computed as follows:

	Tax Liability	Net Income
Per original return filed on or before 3/15/50	$ 9,429.46	$35,721.46
Additional Rental Income per Revenue Agent's Report of 5/9/51		2,529.02
Capital Loss Allowable in 1949 per Revenue Agent's Report of 5/9/51		(1,000.00)
Additional tax assessed per Revenue Agent's Report of 5/9/51	654.74	
Total	$ 10,084.20	$37,250.48
Less: Net operating loss carry-forward deduction		(2,901.86)
Correct tax liability and net income	$ 8,842.60	$34,348.62
Principal tax refund due taxpayers	$ 1,241.60	
Interest Paid	46.20	
Total principal amount of refund due	$ 1,287.80	

B. Plaintiffs' Secondary Position:

Plaintiffs' secondary position is that for income tax purposes Callan's loss from the March 2, 1938 flood was finally and entirely sustained by him in the year 1948 to the extent of the entire amount of such loss.

Under this position, the amount of plaintiffs' net operating loss in 1948 was at least $83,259.02, computed as follows:

Total adjusted cost basis of assets located at 1723 Rancho and 1740 Riverside Drive	$151,165.00
Less: Fair market value of real estate at 1723 Rancho and 1740 Riverside immediately after flood	4,000.00
Amount of loss	$147,165.00

Less: Amount received in final settlement net after attorney's fees and costs in 1948		8,403.05
Net amount of loss in 1948 after reimbursement to extent of settlement proceeds		$138,661.95
Less: Loss already deducted in 1948 income tax return as filed:		
Personal effects	$ 13,800.31	
Business loss	57,796.64	71,596.95
Loss under this alternative position to be added to loss per tax return for 1948		$ 67,065.00
Net loss per 1948 tax return as filed		23,986.81
1948 net loss under this alternative position		$ 91,051.81
Less: Adjustment under Section 122(d) I.R.C. to take long term capital gains into account at 100% instead of 50%		7,792.79
Net operating loss in 1948		$ 83,259.02

Under this alternative position, the net operating loss carryover deduction from 1948 in 1949 is therefore at least $15,678.29, computed as follows:

1948 Net Operating Loss		$ 83,259.02
Less: Amounts carried back to prior years:		
1946	$ 33,582.48	
1947	32,998.25	66,580.73
		$ 16,678.29
Other technical adjustments required under Section 122 of Internal Revenue Code—1949 Capital Loss Disallowed for carry-forward		1,000.00
Net operating loss carry-over deduction from 1948 in 1949		$ 15,678.29

After deduction of this $15,678.29, plaintiffs' correct net income is $21,572.19, correct tax liability

is $4,179.20, and principal tax refund due is $5,905.00.

VI.

That on or about August 24, 1951, plaintiffs duly filed with defendant Robert Riddell, Collector of Internal Revenue for the Sixth District of California, their joint claim for refund for the year 1949 in the sum of $5,951.20 or such greater amount as is legally refundable plus interest as prescribed by law. This refund claim stated as plaintiffs' grounds substantially the same grounds as are set forth in the complaint.

VII.

That more than six months have elapsed since the filing of said refund claim, and defendant Robert Riddell has failed and refused to allow said refund claim or any part thereof, and the Commissioner of Internal Revenue has neither allowed nor disallowed said claim.

VIII.

That defendant Robert Riddell has wrongfully, illegally and erroneously failed and refused, and still fails and refuses to [19] refund to plaintiffs the sum demanded in the aforesaid claim or any portion thereof, and that there is now due, owing and unpaid from said defendant to plaintiffs the aforesaid sum of $5,951.20, together with interest thereon from February 5, 1951, as prescribed by law.

For a further, separate and third cause of action against defendants, plaintiffs allege:

I.

Plaintiffs repeat and replead each and every allegation contained in Paragraphs I to XVI, both inclusive, of plaintiffs' First Cause of Action as though the same were herein set forth at length, but excluding subparagraphs C(b) and C(c) of Paragraph XVI.

II.

That on or before the 15th day of March, 1948, plaintiff Earl Callan filed with the Defendant Harry C. Westover as Collector of Internal Revenue for the Sixth District of California, his income tax return for the year 1947; that plaintiff in said return correctly reported a net income of zero. Plaintiff paid no income tax for the year 1947 at the time of filing said return.

III.

On or about October 10, 1950, the Internal Revenue Agent in Charge for the Los Angeles Division issued his report of examination of plaintiff Earl Callan's 1947 income tax return, claiming additional 1947 tax liability from said plaintiff in principal amount of $14,044.67. Said report erroneously and illegally adjusted plaintiff's 1947 net income from a zero net income to a net income of $32,998.25. Pursuant to this report, defendant Robert Riddell, as Collector of Internal Revenue for the Sixth District of California, wrongfully, illegally and erroneously assessed against plaintiff Earl Callan

an income tax deficiency for the year 1947 in a principal amount of $14,044.67, together with interest in the amount of $2,270.23, or a total of $16,-314.90. On or about February 5, 1951, plaintiff Earl Callan [20] paid under protest said $16,314.90 to defendant Robert Riddell.

IV.

Plaintiff's true income tax liability for the year 1947 was zero.

V.

That the said report of the Internal Revenue Agent in Charge erroneously overstated plaintiff's net income in that the report erroneously and improperly failed to deduct the amounts of plaintiff's net operating loss deductions allowable as a carryback from the year 1948 and a carryforward from the year 1946 under plaintiff's primary position, and allowable as a carryback from the year 1948 under plaintiff's secondary position. Plaintiff's net losses for the years 1946 and 1948 were entirely net operating losses for those respective years within the meaning of Section 122 of the Internal Revenue Code, except for the technical adjustments set forth in the next paragraph of this complaint.

VI.

The income tax and interest assessed against plaintiff Earl Callan and paid by him, as aforesaid, in the sum of $16,314.90 was excessive and incorrectly computed and erroneously assessed, collected and retained by defendant Robert Riddell and the

Internal Revenue Agent in Charge for Los Angeles and the Commissioner of Internal Revenue in the following particulars:

A. Plaintiff's Primary Position:

Plaintiff's primary position is that in 1946, at the time of rendition of jury verdict and judgment for $80,000.00, plaintiff Earl Callan abandoned all efforts to secure any recovery or reimbursement in excess of the sum of $80,000.00 and thereupon, in 1946 finally sustained all of his damages and losses from said flood for income tax purposes, except the $80,000.00 represented by the verdict and judgment against the Los Angeles County Flood Control District. [21]

Under this position, the amount of plaintiff Earl Callan's net operating loss in 1946 was at least $50,-002.05, computed as follows:

Adjusted Cost Basis of Business Assets immediately prior to 1938 flood		$151,165.00
Less: Fair Market Value of Real Estate at 1723 Rancho and 1740 Riverside Drive immediately after said flood	$ 4,000.00	
Reimbursement for above assets represented by 1946 Jury Verdict ($80,000 verdict minus $15,420 for personal non-business items)	64,580.00	68,580.00
Net Amount of loss in 1946 for Income Tax Purposes		$ 82,585.00
Less: Technical Adjustment to Charity Deduction because of said loss	$ 153.50	
Net Income for 1946 except for above loss	34,428.98	
Net Operating Loss for 1946		$ 50,002.05

The net operating loss carryover deduction from 1946 in 1947 is therefore at least $20,706.09, computed as follows:

1946 Net Operating Loss		$ 50,002.05
Less: Amounts carried back to prior years:		
1944	$ 8,362.68	
1945	20,933.28	
Total carried back to prior years		29,295.96
Net operating loss carryover from 1946 to 1947		$ 20,706.09
Technical adjustments required under Section 122 of Internal Revenue Code		None
Net Operating loss carryover deduction from 1946 in 1947		$ 20,706.09

Furthermore, the plaintiff's 1948 income tax return, which set forth the loss in 1948 from settlement of the claim for the $80,000 verdict for $8,403.05, correctly set forth facts which show that the net operating loss carry-back deduction from 1948 in 1947 is at least $16,194.02, computed as follows:

1948 net loss per joint income tax return, as filed, of Earl and Helen Callan		$ 23,986.81
Less: Adjustment under Section 122(d), I.R.C. to take long term capital gains into account at 100% instead of 50%		7,792.79
Net operating loss in 1948		$ 16,194.02
Amounts carried back to prior years		None
Net operating loss carryback from 1948 to 1947		$ 16,194.02
Oher technical adjustments required under Section 122 of Internal Revenue Code		None
Net operating loss carryback deduction from 1948 in 1947		$ 16,194.02

The amount of the 1948 net operating loss carryback to be applied as a deduction and used against 1947 income is at least $12,292.16, since that is the portion thereof necessary to reduce plaintiff's 1947 net income to zero.

The report of October 10, 1950, by the Internal Revenue Agent in Charge of the Los Angeles Division therefore erroneously, illegally and improperly disallowed and failed to subtract the following deduction in computing plaintiff's 1947 net income:

Net operating loss carryover deduction from 1946	$ 20,706.09
Net operating loss carryback deduction from 1948	12,292.16
Total	$ 32,998.25

Because such deductions should have been allowed and subtracted, in accordance with law, plaintiff Earl Callan's correct net income for 1947 is zero, and the correct income tax liability for 1947 is zero. [23]

B. Taxpayer's Secondary Position:

Taxpayer's secondary and alternative position is that for income tax purposes his loss from the March 2, 1938, flood was finally and entirely sustained by him in the year 1948 to the extent of the entire amount of such loss.

Under this position, the amount of taxpayer's net operating loss in 1948 was at least $83,259.02, computed as follows:

Total adjusted cost basis of assets located at 1723 Rancho and 1740 Riverside Drive, per subparagraph A of this paragraph VI	$151,165.00

Less: Fair market value of Real Estate at 1723 Rancho and 1740 Riverside Drive, immediately after flood....		4,000.00
Amount of loss		$147,165.00
Less: Amount received in final settlement net after attorney's fees and costs in 1948		8,403.05
Net amount of loss in 1948 after reimbursement to extent of settlement proceeds		$138,661.95
Less: Loss already deducted on 1948 income tax return as filed:		
Personal Effects	$ 13,800.31	
Business Loss	57,796.64	71,596.95
Loss under this alternative position to be added to loss per tax return for 1948		$ 67,065.00
Net loss per 1948 income tax return as filed		23,986.81
1948 net loss under this alternative positions		$ 91,051.81
Less: Adjustment under Section 122(d), I.R.C., to take long term capital gains into account at 100% instead of 50%		7,792.79
Net operating loss in 1948		$ 83,259.02

Under this alternative position, the net operating loss carryback deduction from 1948 in 1947 is therefore at least $32,998.25, computed as follows:

1948 net operating loss	$ 83,259.02
Less: Amount carried back to 1946	33,582.48
Net operating loss carryback to 1947	$ 49,676.54
Other technical adjustments required under Section 122 of Internal Revenue Code	None
Net operating loss carryback deduction from 1948 in 1947	$ 49,676.54

Under this alternative position, the amount of the 1948 net operating loss carryback to be applied

as a deduction and used against 1947 income is at least $32,998.25, since that is the portion thereof necessary to reduce taxpayer's 1947 net income to zero.

The report of the Internal Revenue Agent in Charge of the Los Angeles Division therefore erroneously, illegally and improperly disallowed and failed to subtract the net operating loss carryback deduction from 1948 in the amount of $32,998.25 in computing taxpayer's 1947 net income.

Because such deductions should have been allowed and subtracted, in accordance with law, taxpayer's correct net income for 1947 is zero, and the correct income tax liability for 1947 is zero.

VII.

On or about August 14, 1951, plaintiff duly filed with the Collector of Internal Revenue for the Sixth District of California, defendant Robert Riddell, a claim for refund in the amount of $16,314.90 or such greater amount as is legally refundable, plus interest prescribed by law, with schedules attached and incorporated in said claim, setting forth the correct tax liability as zero, and setting forth as his grounds substantially the same grounds as are set forth in this complaint. [25]

VIII.

That more than six months have elapsed since the filing of said refund claim, and defendant Robert Riddell has failed and refused to allow said refund

claim or any part thereof, and the Commissioner of Internal Revenue has neither allowed or disallowed said claim.

IX.

That defendant Robert Riddell has wrongfully, illegally and erroneously failed and refused, and still fails and refuses to refund to plaintiff the sum demanded in the aforesaid claim or any portion thereof, and that there is now due, owing and unpaid from said defendant to plaintiff the aforesaid sum of $16,314.90, together with interest thereon from February 5, 1951, as prescribed by law.

For a further, separate and fourth cause of action against defendant, plaintiffs allege:

I.

Plaintiffs repeat and replead each and every allegation contained in Paragraphs I to XV, both inclusive, of plaintiffs' first cause of action as though the same were herein set forth at length.

II.

Plaintiff Earl Callan finally and entirely sustained his loss from the March 2, 1938 flood for income tax purposes in the year 1948 to the extent of the entire amount of such loss. The amount of plaintiffs' net loss in 1948 was therefore at least $91,051.81, and the net operating loss in 1948 was at least $83,259.02, computed as follows: [26]

Total adjusted cost basis of assets located at 1723 Rancho and 1740 Riverside Drive		$151,165.00
Less: Fair market value of real estate at 1723 Rancho and 1740 Riverside Drive immediately after flood		4,000.00
Amount of loss		$147,165.00
Less: Amount received in final settlement net after attorney's fees and costs in 1948		8,403.05
Net amount of loss in 1948 after reimbursement to extent of settlement proceeds		$138,661.95
Less: Loss already deducted on 1948 income tax return as finally sustained in 1948 from flood of 1938:		
Personal effects	$ 13,800.31	
Business loss	57,796.64	71,596.95
Loss to be added to loss per tax return for 1948		$ 67,065.00
Net loss per 1948 income tax return as filed		23,986.81
1948 net loss		$ 91,051.81
Less: Adjustment under Section 122(d) I.R.C., to take long term capital gains into account at 100% instead of 50%		7,792.79
Net operating loss in 1948		$ 83,259.02

The report of the Internal Revenue Agent in Charge of the Los Angeles Division therefore erroneously, illegally and improperly disallowed and failed to subtract losses for 1948 in the amount of $138,661.95 in computing plaintiffs' 1948 net income.

Said losses are deductible in computing plaintiffs' 1948 net loss on the following grounds:

The loss attributable to the business property at 1723 Rancho and 1740 Riverside Drive is a loss sustained in 1948:

(a) incurred in trade or business under Section 23(e)(1), Internal Revenue Code. [27]

(b) Alternatively, as a loss from the involuntary conversion of real and depreciable property used in trade or business, under the provisions of Sections 22(f), 113(a)(9), 111, 113(b), and 117(j) of the Internal Revenue Code.

The loss attributable to the personal effects is a loss sustained in 1948 as a loss of property, not connected with the trade or business, from storm or casualty, not reimbursed by insurance or otherwise, and deductible under Section 23(e)(3) of the Internal Revenue Code.

III.

That on or before the 15th day of March, 1947, plaintiff Earl Callan filed with defendant Harry C. Westover as Collector of Internal Revenue for the Sixth District of California his income tax return for the calendar year 1946; that said plaintiff in that return reported a net taxable income of $32,-428.98 and a total tax liability for the calendar year 1946 of $13,400.67. Said plaintiff paid this $13,-400.67 in full on or before the 15th day of March, 1947, to defendant Harry C. Westover as such Collector.

IV.

That plaintiff Earl Callan's correct 1946 income tax liability at no time exceeded $13,400.67. That at the end of the calendar year 1948, said plaintiff's true and correct 1946 net income and income tax liability for the year 1946 both became zero because

of the plaintiff's net operating loss for the year 1948 of $83,259.02, described in paragraph II of this cause of action. That said $83,259.02 was entirely a net operating loss for 1948 within the meaning of Section 122 of the Internal Revenue Code. That at least $33,582.48 of plaintiff's said 1948 loss was a net operating loss carryback to 1946 within the meaning of Section 122 of the Internal Revenue Code. That the adjustments to said carryback under the provisions of said Section 122 to arrive at the net [28] operating loss carryback deduction for the year 1946 were in the amount of $1,153.50, and that plaintiff's net operating loss carryback deduction for the year 1946 was at least $32,428.98.

V.

That pursuant to the allegations as herein set forth there has been erroneously assessed against plaintiff and claimed and retained from the plaintiff Earl Callan, and he has therefore overpaid his income tax liability for the year 1946 in the principal sum of $13,400.67, together with interest thereon from March 15, 1949, at the rate of 6% per annum, as provided by law.

VI.

That on or about August 14, 1951, plaintiff duly filed with the Collector of Internal Revenue for the Sixth District of California, Robert Riddell, defendant herein, a claim for refund for the year 1946 in the sum of $13,400.67, stating as his grounds substantially the same grounds as are set forth in this complaint.

VII.

That more than six months have elapsed since the filing of said refund claim, and defendant Robert Riddell has failed and refused to allow said refund claim or any part thereof, and the Commission of Internal Revenue has neither allowed nor disallowed said claim.

VIII.

That the claim for refund referred to herein was duly filed within three years from and after the date of filing of the 1948 income tax return of plaintiffs.

IX.

That defendant Harry C. Westover and defendant Robert Riddell have both failed and refused and still fail and refuse to refund to plaintiff Earl Callan the sums demanded in the aforesaid claim, or any portion thereof. That such failure and refusal by either Harry C. Westover or Robert Riddell or by both of them, [29] jointly and/or severally, is wrongful, illegal and erroneous. That there is now due, owing and unpaid to plaintiff Earl Callan by either defendant Harry C. Westover or defendant Robert Riddell or by both of them, jointly and/or severally, the sum of $13,400.67, together with interest thereon at the rate of 6% per annum from March 15, 1949, as prescribed by law.

Wherefore, plaintiffs pray for judgment against defendants as follows:

1. For $18,637.36 on the First Cause of Action;
2. For $5,951.20 on the Second Cause of Action;
3. For $16,314.90 on the Third Cause of Action;
4. For $13,400.67 on the Fourth Cause of Action,

together with interest on each and every such amount, as provided by law, for costs of suit incurred herein, and for such other further relief on each and every such cause of action as the Court may deem meet and proper in the premises.

BRAND, ROSENTHAL, NORTON, & MILLER,
/s/ By HERBERT S. MILLER,
Attorneys for Plaintiffs. [30]

DEMAND FOR JURY TRIAL

Notice to Defendants, Harry C. Westover and Robert Riddell:

Plaintiffs hereby demand trial by jury as to the facts and issues set forth in paragraphs V, VI, VII, VIII, IX and XII of plaintiffs' first cause of action, and as to the same facts and issues under plaintiffs' second, third and fourth causes of action, and as to the issue that under plaintiffs' secondary position the $83,259.02 was entirely a net operating loss for 1948 within the meaning of Section 122 of the Internal Revenue Code and that under plaintiffs' primary position the $16,194.02 was entirely the net

operating loss for 1948 within the meaning of Section 122 of the Internal Revenue Code.

BRAND, ROSENTHAL, NORTON & MILLER,
/s/ By HERBERT S. MILLER,
Attorneys for Plaintiffs. [31]

[Endorsed]: Filed March 10, 1952.

United States District Court for the Southern District of California, Central Division

No. 13357-WM

EARL CALLAN, Plaintiff

vs.

HARRY C. WESTOVER, Defendant.

NOTICE OF MOTION TO DISMISS

To the plaintiff, Earl Callan, and to Brand, Rosenthal, Norton & Miller, his attorneys:

You and each of you will please take notice, that on Monday, the 21st day of April, 1952, at 1:30 p.m., or as soon thereafter as counsel can be heard, in Courtroom No. 2, before the Honorable William C. Mathes, in the Post Office and Court House Building, 312 North Spring Street, Los Angeles, California, defendant will move this Court to dismiss the above entitled case on the ground that the complaint, and each cause of action thereof, fails to state a claim upon which relief can be granted.

Dated: This 3rd day of April, 1952.

WALTER S. BINNS,
United States Attorney
E. H. MITCHELL and
EDWARD R. McHALE,
Assistant U. S. Attorneys
EUGENE HARPOLE and
FRANK W. MAHONEY,
Special Attorneys, Bureau of
Internal Revenue
/s/ EDWARD R. McHALE,
Attorneys for Defendant [32]

Memorandum of Points and Authorities in Support of Motion to Dismiss

Preliminary Statement

The plaintiff seeks recovery of taxes allegedly overpaid and for which he has filed claims for refund for the years 1944, 1945, and 1946. All three causes of action are dependent upon the plaintiff establishing a deductible loss for the year 1946, which, under his second and third causes of action, he seeks to carry back to the years 1944 and 1945 as net operating loss carry-backs. Therefore, if plaintiff fails to establish a deductible loss for the year 1946, all causes of action fall.

Question Presented

Whether the complaint and each cause of action of the complaint fails to state a claim against defendant because the loss occurred, and could only be deducted, in the year 1938.

Statute Involved

Internal Revenue Code, Sec. 23. Deductions from gross income.

In computing net income, there shall be allowed as deductions:

(e) Losses by individuals.—in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *

Statement of Facts

For the purposes of this motion, taking the allegations of fact as true, the following is a concise statement of the material facts (paragraphs V through IX, exclusive):

The plaintiff suffered a property loss of $220,-740.00, not compensated for by insurance, by reason of a flood in March, 1938. Plaintiff filed a claim against Los Angeles Flood Control District which was denied in December, 1938. Plaintiff attempted to recover from the Los Angeles Flood Control District the amount of his losses by a legal action filed in 1939. In 1946, plaintiff recovered a jury verdict for part of the amount of the claimed loss, $80,000.

In 1947, the Los Angeles Flood Control District was granted a new trial, which order granting the new trial after appeal to the California [33] Supreme Court, became final in 1947. In 1948, plaintiff settled his claim against the Los Angeles Flood Control District for $8,403.05.

The Loss occurred in 1938 and was not compensated for by insurance or otherwise.

I. The Loss occurred in 1938.

The Supreme Court, in the leading case, United States vs. White Dental Company, 274 U.S. 398, said that the loss statute contemplates the deduction from gross income of losses which are fixed by identifiable events such as the sale of property or losses caused by its destruction or physical injury. The flood which occurred in March, 1938, was such an identifiable event.

II. The Loss was not compensated for by insurance.

The Internal Revenue Code states that there shall be allowed as deductions losses sustained during the taxable year and not compensated for by insurance or otherwise.

In paragraph XII of the complaint, plaintiff alleged that the loss was not reimbursed by insurance.

III. The Loss occurred in 1938 and was not compensated for "otherwise".

In December, 1938, the Los Angeles Flood Control District had denied liability for the damages sustained by plaintiff. (Complaint, para. VII) Therefore, in 1938 plaintiff had suffered a loss not compensated for by insurance or otherwise.

> Commissioner vs. Highway Trailer Co., 72 F.(2d) 913 (7 Cir., 1934), cert. den. 293 U.S. 626, 79 L.Ed. 713, 55 S.Ct. 731; petition for rehearing denied, 294 U.S. 731, 79 L.Ed. 1261, 55 S.Ct. 505.

In that case a Wisconsin corporation suffered a fire in 1921 which destroyed property of the value

of $165,000 not covered by insurance. In 1921 the taxpayer sued the Janesville Electric Company for negligence. In 1924 taxpayer recovered a $47,000 judgment and thereupon wrote off its books the difference of $118,000, and claimed a deduction of that amount in its 1924 income tax return. The Electric Company appealed the judgment and secured its reversal in 1925. The taxpayer then claimed a $47,000 deduction in 1925. The Commissioner [34] disallowed both deductions, holding that the entire deduction should have been claimed for 1921. The Board of Tax Appeals sustained the taxpayer, but the Court of Appeals for the 7th Circuit reversed the Board of Tax Appeals.

The Court held, at page 915, as follows:

"Where, as in the case at bar, an actual physical loss occurs, resulting in a certain definite, fixed amount of damage, it seems better practice to allow the deduction for that entire amount of damage (not covered by insurance) in the year in which the loss actually occurs, according to the rule in the White Dental Case, rather than to defer it until the subsequent events indicate whether or not a recovery is to be had from other parties for a part of the loss. We think that this does not conflict with the rule of the Huff Case, supra, that 'the loss "must be actual and present"' because the loss is actual and present as soon as the physical damage occurs, as distinct from the situation where the loss claimed arises from a liability which may or may not ever materialize."

The Highway Trailer Case is on all fours with the case at bar. The similarity of the facts of the two cases is striking.

It is clear under the doctrine of that case that Earl Callan had a deductible loss in the year 1938 but none in the year 1946.

In Commissioner vs. John Thatcher & Son, 76 F.(2d) 900 (2 Cir., 1935) the Court said, at page 902:

"The loss occurred when the expenditures were made and was then deductible unless it was compensated for by insurance or otherwise. We think that the taxpayer's claim for damages against the subcontractor and other sureties was too contingent and uncertain to be treated as compensation by 'insurance or otherwise' for the loss." [35]

The belief of Earl Callan that he could obtain reimbursement of his loss by legal action against the Los Angeles Flood Control District (Complaint, paragraph VII) was "too contingent and uncertain" in the words of the 2nd Circuit to be treated as compensation by "insurance or otherwise".

Conclusion

Because the facts alleged clearly show that plaintiff suffered a loss by reason of a flood in March, 1938, which was an identifiable event, and because the loss was not compensated for by insurance or otherwise, it is respectfully submitted that plaintiff, in his suit on claims for refund based on a loss sought to be deducted in the year 1946, fails to state a claim against the defendant upon which relief may

be granted. Therefore, the complaint should be dismissed. [36]

Affidavit of Service by Mail Attached. [37]

[Endorsed]: Filed April 4, 1952.

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: June 11, 1952, at: Los Angeles, Calif.

Present: The Honorable Wm. C. Mathes, District Judge; Deputy Clerk: P. D. Hooser; Reporter: A. H. Bargion; Counsel for Plaintiffs: no appearance; Counsel for Defendants: Edw. R. McHale, Ass't U.S. Att'y.

Proceedings: For hearing re extension of time for Gov't to plead herein, for the reason that a motion to dismiss the similar case of Earl Callan vs. Westover, Civil No. 13,357-WM, is under submission by this Court at this time.

It is ordered, on motion of Attorney McHale, that time for Gov't to plead herein is extended to July 31, 1952.

EDMUND L. SMITH,
Clerk [38]

[Title of District Court and Cause No. 13357.]

ORDER ON DEFENDANT'S MOTION TO DISMISS

This cause having come before the court for hearing on defendant's motion, filed April 4, 1952, to dismiss plaintiff's complaint for failure to state a claim or cause of action for which relief can be granted [Fed. R. Civ. P. 8(a), 12(b)(6)]; and the motion having been argued and submitted for decision; and it appearing to the court:

(a) that plaintiff seeks inter alia to recover income taxes claimed to have been erroneously paid for the year 1946, and this recovery is sought upon the ground that certain of plaintiff's property was allegedly destroyed by flood in 1938, and he "strongly believed and was advised by his attorneys that he could obtain reimbursement" from Los Angeles County Flood Control District, and plaintiff did diligently press suit until a settlement and partial [39] reimbursement was effected in 1948;

(b) that since destruction of plaintiff's property by flood was an "identifiable event," plaintiff's claimed loss must be considered as sustained during the taxable year of 1938 [26 U.S.C. § 23(e); United States vs. White Dental Co., 274 U.S. 398, 401 (1927); CIR vs. Highway Trailer Co., 72 F.2d 913, 914-915 (7th Cir. 1934), cert. denied, 293 U.S. 626 (1935)]; and

(c) that inasmuch as any loss which Los Angeles County Flood Control District might assert for

1938 because of possible liability to plaintiff would be disallowed as "too contingent" [Burnet vs. Huff, 288 U.S. 156, 160 (1933); Lucas vs. American Code Co., 280 U.S. 445, 450 (1930)], plaintiff's claim against the Flood Control District must likewise be held "too contingent and uncertain to be treated as compensation by 'insurance or otherwise'" within the meaning of 26 U.S.C. § 23(e) [CIR vs. John Thatcher & Son, 76 F.2d 900, 902 (2d Cir. 1935); Hinrichs vs. Helvering, 95 F.2d 117, 118 (D.C. Cir. 1938); Niagara Share Corp. vs. CIR, 82 F.2d 208, 211-212 (4th Cir. 1936); CIR vs. Highway Trailer Co., supra, 72 F.2d at 913];

It is now ordered that defendant's motion to dismiss, filed April 4, 1952, be and is hereby granted upon the ground that the facts alleged in plaintiff's complaint do not constitute a claim or cause of action for which relief can be granted [Fed. R. Civ. P. 12(b)(6)], with leave to plaintiff to serve and file amended complaint within twenty days from the date of this order if so advised.

It is further ordered that the Clerk this day serve [40] copies of this order by United States mail on the attorneys for the parties appearing in this cause.

Dated: September 18, 1952.

/s/ WM. C. MATHES,
United States District Judge. [41]

[Endorsed]: Filed Sept. 18, 1952.

[Title of District Court and Cause No. 13922.]

NOTICE OF MOTION AND MOTION TO DISMISS

To the plaintiffs, Earl Callan and Helen Callan, and to Brand, Rosenthal, Norton and Miller, their attorneys:

You, and each of you, will please take notice, that on Monday, October 13, 1952, at 1:30 p.m., or as soon thereafter as counsel can be heard, in Courtroom No. 2, before the Honorable William C. Mathes, in the Post Office and Court House Building, 312 North Spring Street, Los Angeles, California, defendants will move this Court to dismiss the above entitled case on the ground that the complaint, and each cause of action thereof, fails to state a claim upon which relief can be granted.

Dated: This 1st day of October, 1952.

WALTER S. BINNS,
United States Attorney

E. H. MITCHELL and
EDWARD R. McHALE,
Assistant U.S. Attorneys

EUGENE HARPOLE and
FRANK W. MAHONEY,
Special Attorneys, Bureau of Internal Revenue

/s/ EDWARD R. McHALE,
Attorneys for Defendants [42]

Memorandum of Points and Authorities in Support of Motion to Dismiss

This motion is based upon the memoranda of points and authorities filed in support of the motion to dismiss in Earl Callan vs. Westover, Civil No. 13357-WM, and the Order of Court granting said motion, filed on September 18, 1952.

The substantive facts alleged in the complaint in the case at bar are the same as those alleged in case No. 13357-WM. The gravamen of plaintiffs' claim in said case was set forth in paragraphs V, VI, VII, VIII and IX of the first cause of action and by reference incorporated in the other causes of action. With but one change, the omission of a conclusion of law, said paragraphs are set forth verbatim as paragraphs V, VI, VII, VIII and IX, respectively, of the first cause of action of the complaint herein, and are incorporated by reference in each and every other cause of action herein.

The sole change in said paragraphs was the omission herein of part of the last sentence in paragraph VII in case No. 13357-WM, the following conclusion of law:

> "and thereupon [1946] finally sustained all of his damages and losses from said flood except the $80,000 represented by the verdict of the Los Angeles Flood Control District."

In the case at bar, Earl Callan and his wife, Helen, are joined as plaintiffs, because the four different refund claims upon which this suit is based and which concern the calendar years 1946, 1947,

1948, and 1949, are essentially based on plaintiffs' contention that the loss occurred in the year 1948, a year in which the plaintiffs filed joint returns. They also filed joint returns in 1949.

By reason of the net operating loss carry-over and carry-back provisions of the Internal Revenue Code, plaintiffs seek to carry forward and back said "losses" from the year 1948 to the years 1949, 1946 and 1947.

The first cause of action of plaintiffs' complaint is based on the [43] refund claim for the year 1948 and presents alternative theories. The first contention is that the balance of the flood loss not claimed in 1946 (in case No. 13357) occurred in 1948 when the final and only recovery of $8,400 for damages was made. On the other hand, the contention is made that the entire deductible loss occurred for the taxpayers in 1948. As the other causes of action are dependent upon one or the other of these two theories and seek only to carry over or back said "1948 loss" to 1946, 1947, and 1949, the ruling of the Court in action No. 13357-WM is wholly decisive of this motion.

On the facts therein alleged, which are the same as herein alleged, the Court ruled that destruction of plaintiffs' property by flood was an "identifiable event" giving rise to a loss sustained during the taxable year 1938 and as any loss which the Los Angeles Flood Control District might assert for 1938 because of possible liability to plaintiffs would be disallowed as too contingent, plaintiffs' claim against the Flood Control District must likewise be

held too contingent and uncertain to be treated as "insurance or otherwise" within the meaning of 26 U.S.C. §23(e).

On the basis of the decision and Order of Court in action No. 13357-WM, it is respectfully submitted that plaintiffs' complaint herein fails to state a claim or cause of action and should be dismissed.

Affidavit of Service by Mail attached. [45]

[Endorsed]: Filed Oct. 1, 1952.

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Oct. 13, 1952, at Los Angeles, Calif.

Present: The Hon. Wm. C. Mathes, District Judge; Deputy Clerk: R. B. Clifton; Reporter: A. H. Bargion; Counsel for Plaintiff: Herbert S. Miller; Counsel for Defendants: Edw. R. McHale, Ass't U.S. Att'y.

Proceedings: For hearing on motion of defendants to dismiss, pursuant to notice of Oct. 1, 1952.

It is ordered that cause as to hearing on said motion is continued to Oct. 15, 1952, 1:30 p.m.

EDMUND L. SMITH,
Clerk

/s/ By R. E. CLIFTON,
Deputy Clerk [46]

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Oct. 15, 1952, at Los Angeles, Calif.

Present: The Hon. Wm. C. Mathes, District Judge; Deputy Clerk: S. W. Stacey; Reporter: A. H. Bargion; Counsel for Plaintiff: Herbert S. Miller; Counsel for Defendant: Edw. R. McHale, Ass't U.S. Att'y.

Proceedings: For hearing on motion of defendants to dismiss, pursuant to notice of Oct. 1, 1952. Court hears argument of counsel.

It is ordered that cause be submitted on said motion of defendants to dismiss.

EDMUND L. SMITH,
Clerk [60]

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Sept. 28, 1953, at Los Angeles, Calif.

Present: The Hon. Wm. C. Mathes, District Judge; Deputy Clerk: Edw. F. Drew; Reporter: A. H. Bargion; Counsel for Plaintiffs: no appearance; Counsel for Defendants: E. R. McHale, Att'y, Bur. Int. Rev.

Proceedings: For oral argument.

It is ordered, on motion of Att'y McHale, that cause is continued to Oct. 1, 1953, 10 a.m., for oral argument.

EDMUND L. SMITH,
Clerk [61]

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Oct. 1, 1953, at Los Angeles, Calif.

Present: The Hon. Wm. C. Mathes, District Judge; Deputy Clerk: Edw. F. Drew; Reporter: A. H. Bargion; Counsel for Plaintiffs: Herbert S. Miller; Counsel for Defendant: Edward R. McHale, Ass't U.S. Att'y.

Proceedings: For oral argument on motion to dismiss. Each of Attorneys McHale and Miller, respectively, makes a statement. Court makes a statement and orders cause as to motion to dismiss be submitted.

EDMUND L. SMITH,
Clerk [62]

[Title of District Court and Cause No. 13922.]

STIPULATION AND ORDER ALLOWING AMENDMENT OF COMPLAINT AND SUBMITTING THE MOTION TO DISMISS ON THE AMENDED COMPLAINT

It is hereby stipulated, by and between the parties hereto through their respective counsel of record, as follows:

1. That plaintiffs' complaint on file is hereby amended in the following particulars: that the punctuation period after the word "District" on line 26, page 4 of the complaint is hereby stricken and the

following language inserted: "and in fact had a reasonable chance at the end of the year 1938 to obtain said reimbursement and possibly a profit."

2. Motion to dismiss complaint and the memoranda in support of and in opposition thereto, with respect to the original complaint in this action shall be deemed to apply to the complaint as amended herein and the motion submitted to the Court.

Dated: At Los Angeles, California, this 24th day of October, 1952. [63]

BRAND, ROSENTHAL,
NORTON & MILLER,
/s/ By HERBERT S. MILLER,
Attorneys for Plaintiffs
WALTER S. BINNS,
United States Attorney
E. H. MITCHELL and
EDWARD R. McHALE,
Assistant U.S. Attorneys
EUGENE HARPOLE and
FRANK W. MAHONEY,
Special Attorneys, Bureau of
Internal Revenue,
/s/ EDWARD R. McHALE,
Attorneys for Defendants

It is so ordered this 27th day of October, 1952.

/s/ WM. C. MATHES,
Judge [64]

[Endorsed]: Filed Oct. 27, 1952.

[Title of District Court and Cause No. 13357.]

STIPULATION AND ORDER FOR SUBMITTING MOTION TO DISMISS AMENDED COMPLAINT ON MEMORANDA HERETOFORE FILED

It is hereby stipulated between plaintiff and defendant through their respective counsel of record as follows:

1. That the motion to dismiss the original complaint and the memoranda in support of and in opposition thereto be deemed to apply to the amended complaint, and that the matter be submitted to the Court on said motion and memoranda.

Dated: At Los Angeles, California, this 24th day of October, 1952.

BRAND, ROSENTHAL,
NORTON & MILLER,
/s/ By HERBERT S. MILLER,
Attorneys for Plaintiff
WALTER S. BINNS,
United States Attorney,
E. H. MITCHELL and
EDWARD R. McHALE,
Assistant U.S. Attorneys
EUGENE HARPOLE and
FRANK W. MAHONEY,
Special Attorneys, Bureau of
Internal Revenue
/s/ EDWARD R. McHALE,
Attorneys for Defendant

It is so ordered this 25th day of October, 1952.

/s/ WM. C. MATHES,
Judge [65]

[Endorsed]: Filed Oct. 27, 1952.

[Title of District Court and Cause No. 13922.]

ORDER ON MOTION TO DISMISS

This cause having come before the court for hearing on defendants' motion filed October 1, 1952 to dismiss the action; and the motion having been argued and submitted for decision;

It is now ordered that defendants' motion to dismiss the action is hereby denied.

It is further ordered that the Clerk this day serve copies of this order by United States mail on the attorneys for the parties appearing in this cause.

October 30, 1953.

/s/ WM. C. MATHES,
U.S. District Judge [66]

[Endorsed]: Filed Oct. 30, 1953.

[Title of District Court and Cause No. 13357.]

MEMORANDUM OF DECISION

Plaintiff brought this action to recover income taxes claimed to have been erroneously paid to defendant as Collector of Internal Revenue for the

calendar year 1946. Jurisdiction of this court is invoked under 28 U.S.C. § 1340. [See: Lowe Bros. Co. vs. United States, 304 U.S. 302, 305 (1938); Sage vs. United States, 250 U.S. 33, 37 (1919); 28 U.S.C. § 2006 and Reviser's Note fol. § 1346, 28 U.S.C.A. 154 (1950).]

The original complaint was dismissed upon motion for failure to state a claim or cause of action for which [67] relief could be granted [Fed. Rules Civ. Proc., Rules 8(a), 12(b)(6), 54(c), 28 U.S.C.A. 252, 336, 116 (1950)], and defendant now moves upon the same grounds to dismiss the amended complaint.

The material facts alleged in the amended complaint are briefly these. Prior to and on and after March 2, 1938 plaintiff was the owner of certain real property improved with two dwelling houses and other fixtures and furnished and equipped with various items of personalty. The total cost to plaintiff of the entire property so improved and equipped was $166,535, after deducting depreciation allowed and allowable. [See: Int. Rev. Code §§ 23(i), 113 (b), 26 U.S.C. §§ 23(i), 113(b), U. S. Treas. Reg. 111, § 29.23(i)-1, 26 CFR § 29.23(i)-1.]

It is next alleged that since prior to 1938 "plaintiff has been engaged in the business of constructing, furnishing, owning, operating and renting residential real estate"; and that at the time of the calamity later described one of the two dwelling houses in question was occupied by a paying tenant and the other by plaintiff in keeping with plaintiff's "business practice * * * to occupy residences in

order to more advantageously display such residences to prospective tenants or purchasers * * *"

Then follow allegations that on or about March 2, [68] 1938, "the Los Angeles River overflowed its banks * * * suddenly, and caused a flood which inundated plaintiff's said real estate * * * and entirely washed away and destroyed all * * * improvements * * * and all * * * personal property * * * and so damaged plaintiff's land * * * that the aggregate value * * * after said flood was only Four Thousand Dollars * * *." There is no mention of any insurance.

Plaintiff further alleges: that following the flood he "strongly believed and was advised by his attorneys that he could obtain reimbursement for the damages to his property by legal action against the Los Angeles County Flood Control District and in fact had a reasonable chance at the end of the year 1938 to obtain said reimbursement and possibly a profit"; that accordingly he filed a claim for $220,740 against the Flood Control District, which claim was denied; that he thereupon filed suit against the Flood Control District in the California Superior Court "and continuously and diligently prosecuted the case thereafter"; that the case went to trial by jury in 1946, and a verdict for $80,000 was returned in favor of plaintiff; that he "made no motion for a new trial, nor * * * attempt to secure any remedy other than judgment for the amount of said verdict"; that he "thereupon and at that time in the year 1946 abandoned all efforts to secure any recovery or reimbursement in excess of * * * $80,000

[69] represented by the verdict"; that the Superior Court, upon motion of the Flood Control District, set aside the verdict and ordered a new trial; that plaintiff appealed from the order granting a new trial, but the District Court of Appeal affirmed [Stone, et al. vs. Los Angeles County Flood Control District, 81 Cal. App. 2d 902, 185 P.2d 396 (1942)], the California Supreme Court refused plaintiff's petition for a hearing [id., 81 Cal. App. 2d at 912, 185 P.2d at 396] and the case was thereupon remanded for a new trial; that "in the year 1948, plaintiff executed an agreement of settlement * * * with the * * * Flood Control District," and his "net recovery in said settlement after attorneys' fees and court costs was * * * $8,403.05."

Plaintiff also alleges that he regularly filed his return and paid defendant the $13,400.67 income tax shown thereon for the calendar year 1946, without deducting any amount as a loss sustained during the taxable year 1946 by reason of the 1938 flood; that "his true income tax liability for the year 1946 was zero"; that the computations shown on his 1946 return were erroneous and the tax was erroneously collected by defendant because "abandonment by plaintiff in the year 1946 of his claim for reimbursement and/or the rendition of the jury verdict and Superior Court judgment for only $80,000 represented the sustaining of a loss by plaintiff in [70] that year * * * of at least $82,585 not reimbursed by insurance or otherwise * * *." [See: Int. Rev. Code § 23(e), 26 U.S.C. § 23(e).]

In conclusion it is alleged that in 1948 plaintiff

filed an amended return for 1946 "setting forth the correct tax liability as zero," along with a claim against defendant for a refund of the entire $13,400.67 tax theretofore paid defendant as plaintiff's 1946 tax; and that on or about March 13, 1950 the Commissioner of Internal Revenue rejected the claim in full. This action followed.

Section 23 of the Internal Revenue Code provides in part that: "In computing net income there shall be allowed as deductions: * * *

(e) In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise (1) if incurred in trade or business; or (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or (3) of property not connected with the trade or business, if the loss arises from fires, storms, * * * or other casualty, or from theft." [26 U.S.C. §23(e).]

The precise question presented by the motion to dismiss [71] at bar is whether, on the facts alleged in the amended complaint, the court could properly hold as a matter of law that any part of the loss suffered by plaintiff as a proximate consequence of the 1938 flood was "sustained during the taxable year" of 1946 [26 U.S.C. §§ 41, 48] "and not compensated for by insurance or otherwise," within the meaning of the quoted provisions of § 23(e). [Cf. Commissioner vs. Highway Trailer Co., 72 F.2d 913, 915 (dissenting opinion, 7th Cir. 1934), cer. denied, 293 U.S. 626 (1935).]

The applicable regulations of the Commissioner

[26 U.S.C. §§ 62, 3791] provide that: "In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses." [U.S. Treas. Reg. 111, § 29.23(e)-1(b), 26 CFR § 23(e)-1(b).]

These regulations, as the Court observed in Boehm vs. Commissioner, 326 U.S. 287, 291-292 (1945), have been "long continued without substantial change * * * and have the effect of law." [See e.g.: United States vs. White Dental Co., 274 U.S. 398 (1927); First Nat. Corp. vs. Commissioner, 147 F.2d 462 (9th Cir. 1945); Commissioner vs. Peterman, 118 F.2d 973 (9th Cir. 1941); Cahn vs. Commissioner, 92 F.2d [72] 674 (9th Cir. 1937).]

Defendant contends in support of the motion that destruction of plaintiff's property by flood was the "identifiable event" which fixed the time of plaintiff's loss, that the loss was admittedly not "compensated for by insurance or otherwise," and hence must be deemed "evidenced by [a] closed and complete transaction" within the meaning of the quoted regulations, since the alternative phrase "or otherwise" denotes, says defendant, nothing more or less than a consensual undertaking comparable to a contract of insurance, such as the unequivocal contractual obligation of some third person to reimburse the taxpayer in whole or in part.

In other words, the argument goes, the law in-

tends that both the taxpayer and the Government should know with certainty when a loss is deductible; that the purpose of the statute [26 U.S.C. § 23(e)] is to establish a predictable rule which both permits and requires the taxpayer in a case like that at bar to make the deduction for the year in which the "physical damage" occurs [see Commissioner vs. Highway Trailer Co., supra, 72 F.2d at 915], unless "compensated for" by insurance or other contract such as will permit of a deduction later for loss from "bad debts" within § 23(k) of the Internal Revenue Code [26 U.S.C. § 23(k)], in the event the insurer or other obligor should default and the taxpayer [73] thus fail in his efforts at recoupment. [Cf. John H. Farish & Co. vs. Commissioner, 31 F.2d 79, 81 (8th Cir. 1929); Farmers etc. Exchange vs. Commissioner, 10 B.T.A. 379, 381 (1928).]

Upon granting defendant's motion to dismiss the original complaint I was persuaded that this narrow construction of § 23(e) urged by defendant was sound both in reason and in policy, that the rule urged by defendant made for certainty and predictability for both the taxpayer and the Government and was, moreover, permissible under precedents which by stare decisis bind this court.

That holding was made "in the light of the now familiar rule that an income tax deduction is a matter of legislative grace * * * that the burden of clearly showing the right to the claimed deduction is on the taxpayer" [Interstate Transit Lines vs. Commissioner, 319 U.S. 590, 593 (1943)], and that

"only as there is clear provision therefor can any particular deduction be allowed." [New Colonial Ice Co. vs. Helvering, 292 U.S. 435, 440 (1934).]

However, further consideration of the problem in connection with the pending motion and the more recent decision in Alison vs. United States, 344 U.S. 167 (1952), have combined to convince me that it was error to grant defendant's [74] motion to dismiss the original complaint in this action.

Although Alison involved loss resulting from a concealed embezzlement, the rationale of the opinion and the implied reaffirmation of the rationale of Boehm vs. Commissioner, supra, 326 U.S. 287, serve to make the holding applicable in the case at bar. This is clearly so when Alison and Boehm are considered in the light of earlier pronouncements of the Court treating with kindred problems, keeping in mind differences existing from time to time in the scope of review of decisions of the Tax Court. [See: Dobson vs. Commissioner, 320 U.S. 489, 496-498, 501-502 (1943); 26 U.S.C. § 1141(a); Fed. Rules Civ. Proc., Rule 52, 28 U.S.C.A. 13 (1950); Arrowsmith vs. Commissioner, 344 U.S. 6, 12 (dissenting opinion, 1952).]

Thus it seems now to be settled that losses not evidenced by "closed and completed transactions," within the meaning of the regulations, must be held "compensated for by * * * or otherwise," within the meaning of § 23(e). [26 U.S.C. § 23(e); e.g. Alison vs. United States, supra, 344 U.S. 167 [Whitney vs. Commissioner, 13 T.C. 897 (1949).] The problem then is to determine in a given case

whether the loss in question is evidenced by a "closed and completed" transaction.

To be deductible, Mr. Justice Holmes wrote in Weiss [75] vs. Wiener, 279 U.S. 333, 335 (1929), "the loss must be actual and present, not merely contemplated as more or less sure to occur in the future." Thus the "mere existence of liability [on the part of the taxpayer] is not enough to establish a deductible loss." [Burnet vs. Huff, 288 U.S. 156, 160 (1933).]

Nor is the mere existence of an unsatisfied claim for recoupment in favor of the taxpayer enough to prevent the loss from being held deductible. In United States vs. White Dental Co., supra, 274 U.S. at 402-403, the court said: "The quoted regulations, consistently with the statute, contemplate that a loss may become complete enough for deduction without the taxpayer's establishing that there is no possibility of an eventual recoupment * * *. The Taxing Act does not require the taxpayer to be an incorrigible optimist. We need not attempt to say what constitutes a closed transaction evidencing loss in other situations. It is enough to justify the deduction here that the transaction causing the loss was completed when the seizure was made. It was none the less a deductible loss then, although later the German government bound itself to repay and an award was made by the Mixed Claims Commission which may result in a recovery."

The Court speaking through Mr. Justice Brandeis in Lucas vs. American Code Co., 280 U.S. 445, 449 (1930) explained and extended the rule in this

way: "Generally speaking, the [76] income-tax law is concerned only with realized losses, as with realized gains * * *. Exception is made however in the case of losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduction, in certain circumstances, before they are absolutely realized. As respects losses occasioned by the taxpayer's breach of contract, no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test." [Accord, Burnet vs. Huff, supra, 288 U.S. at 161; cf. Eckert vs. Burnet, 283 U.S. 140 (1931).]

Some ten years later, in Smith vs. Helvering, 141 F.2d 529, 531 (D.C. Cir. 1944), it was held that the proper test to be employed in determining whether a loss arising from worthless corporate stock has been sustained during a particular tax period is the subjective one.

The year following, in Boehm vs. Commissioner, 146 F.2d 553, 555 (2d Cir. 1945), the Court of Appeals for the Second Circuit "approved the objective rather than the subjective test," declaring: "In so far as Smith vs. Helvering * * * adopts the subjective test we must respectfully disagree with it." [77]

The Supreme Court granted certiorari in the Boehm case [325 U.S. 847 (1945)] and, upon affirming the decision of the Second Circuit, declared that "unmistakable phraseology [of § 23(e)] com-

pels the conclusion that a loss, to be deductible * * * must have been sustained in fact during the taxable year. And a determination of whether a loss was in fact sustained in a particular year cannot fairly be made by confining the trier of facts to an examination of the taxpayer's beliefs and actions. Such an issue of necessity requires a practical approach, all pertinent facts and circumstances being open to inspection and consideration regardless of their objective or subjective nature * * *. The standard for determining the year for deduction of a loss is thus a flexible, practical one, varying according to the circumstances of each case. The taxpayer's attitude and conduct are not to be ignored, but to codify them as the decisive factor in every case is to surround the clear language of § 23(e) and the Treasury interpretations with an atmosphere of unreality and to impose grave obstacles to efficient tax administration." [Boehm vs. Commissioner, supra, 326 U.S. at 292-293.]

The ratio decidendi of Boehm was in effect reaffirmed in Alison vs. United States, supra, 344 U.S. at 170, by the holding that: "Whether and when a deductible loss results * * * is a factual question * * * to be decided according to [78] surrounding circumstances."

As if to give emphasis to the "flexible" standard described in Boehm, the Court in Alison added the declaration that: "An inflexible rule is not needed: the statute does not compel it." [Ibid. See IRS Rev. Rul. 183, Sept. 14, 1953, 22 L.W. 2123 (1953).]

This "flexible, practical" standard ex necessitate

includes an objective test of the reasonableness of the taxpayer's action "according to the surrounding circumstances," since under our common-law system of justice the ultimate standard in the application of every rule is one of reasonableness. [See: Funk vs. United States, 290 U.S. 371, 383-385 (1933); Pound, The Spirit of the Common Law, 182-183 (1921); Pound, Justice According to Law, 60 (1951).]

Applied to a case like that at bar the test is whether or not, "according to the surrounding circumstances," the taxpayer acted or failed to act with "reasonable cause" — exercised "ordinary business care and prudence" — in considering and treating the claimed loss as "evidenced by [a] closed and completed transaction * * * fixed by [an] identifiable event * * * [and] bona fide and actually sustained during the taxable period" for which claimed as a deduction. [U.S. Treas. Reg. 111, § 25.23(e)-1(b), 26 CFR § 29.23(e)-1(b); [79] 2 Restatement, Torts, § 283 (1934); cf. U.S. Treas. Reg. 103, § 29.291-1, 26 CFR § 29.291-1; Note, 64 Harv. L. Rev. 345 (1950).]

"According to the surrounding circumstances" may encompass myriad criteria for guaging the reasonableness of the taxpayer's action or inaction, such as whether there was "an actual physical loss * * * resulting in a certain definite, fixed amount of damage" [see Commissioner vs. Highway Trailer Co., supra, 72 F.2d at 915; cf. Rhodes vs. Commissioner, 100 F.2d 966 (6th Cir. 1939)], and whether there was any other identifiable later event which

might reasonably be looked to in fixing the date of loss [e.g. Burnet vs. Huff, supra, 288 U.S. at 160-162; Lucas vs. American Code Co., supra, 280 U.S. at 449-450; Belser vs. Commissioner, 174 F.2d 387, 389-390 (4th Cir. 1949). And the taxpayer's "attitude and conduct are not to be ignored." [Boehm vs. Commissioner, supra, 326 U.S. at 293.]

In the light of these factors, "determination of the year of loss calls for * * * a consideration of all pertinent facts and circumstances, regardless of their objective or subjective nature." [Mine Hill etc. R. Co. vs. Smith, 184 F.2d 422, 426 (3d Cir. 1950); Acheson vs. Commissioner, 155 F.2d 369, 371 (5th Cir. 1946); Harral vs. United States, 81 F. Supp. 983, 986 (W. D. Tex. 1949).] [80]

Thus the statutory limitation that a deductible loss is not sustained if "compensated for by insurance or otherwise" places every reasonable possibility of recoupment among the "pertinent facts and circumstances." [United States vs. White Dental Co., supra, 274 U.S. at 402-403; First Nat. Corp. vs. Commissioner, supra, 147 F.2d at 464; Cahn vs. Commissioner, supra, 92 F.2d at 676; Douglas Co. L. & W. Co. vs. Commissioner, 43 F.2d 904, 905 (9th Cir. 1930); see: Commissioner vs. Harwick, 184 F.2d 835 (5th Cir. 1950); Boston Consol. Gas Co. vs. Commissioner, 128 F.2d 473, 476-477 (concurring opinion, 1st Cir. 1942); H.D. Lee Mercantile Co. vs. Commissioner, 79 F.2d 391 (10th Cir. 1935); Louisville Trust Co. vs. Glenn, 33 F. Supp. 403, 408 (W. D. Ky. 1940), aff'd, 124 F.2d 418 (6th Cir. 1942); George M. Still, Inc. vs. Commissioner,

19 T.C. 1072 (1953); Whitney vs. Commissioner, supra, 13 T.C. at 901; Paul and Mertons, 3 Law of Federal Income Taxation, § 26.54 (1934). Contra: Commissioner vs. Highway Trailer Co., supra, 72 F.2d at 915.]

The precise test then in a case such as that at bar is whether a reasonable taxpayer exercising ordinary business care and prudence would have treated the matter as a "closed and completed" transaction and claimed the deduction as a "realized loss" for the taxable year in which physical loss occurred, without regard to possible recoupment in some future year. [Compare H. D. Lee Mercantile Co. vs. Commissioner, supra, 79 F.2d at 393.] [81]

The taxpayer may not reasonably defer the deduction for loss until some more tax-advantageous year by pursuing a tenuous claim for recoupment. [Boehm vs. Commissioner, supra, 326 U.S. at 290-291, 293-295; Cahn vs. Commissioner, supra, 92 F.2d at 676; see: Clark vs. Welch, 140 F.2d 271, 273-274 (1st Cir. 1944); Jones vs. Commissioner, 103 F.2d 681, 685 (9th Cir. 1939); Hinrichs vs. Helvering, 95 F.2d 117 (D.C. Cir. 1938).] To paraphrase Mr. Chief Justice Stone's oft-quoted dictum in United States vs. White Dental Co., supra, 274 U.S. at 403, the law does not permit or require the taxpayer to be an incorrigible optimist. [See: Niagara Share Corp. vs. Commissioner, 82 F.2d 208, 211-212 (4th Cir. 1936); Commissioner vs. John Thatcher & Son, 76 F.2d 900, 902 (2d Cir. 1935); Commissioner vs. Highway Trailer Co., supra, 72 F.2d at 914-915.]

By the same token, the law does not permit or require the taxpayer to be an incorrigible pessimist. [See: Lucas vs. American Code Co., supra, 280 U.S. at 450; Acheson vs. Commissioner, supra, 155 F.2d at 371; First Nat. Corp. vs. Commissioner, supra, 147 F.2d at 464; Commissioner vs. Winthrop, 98 F.2d 74 (2d Cir. 1938); H. D. Lee Mercantile Co. vs. Commissioner, supra, 79 F.2d at 393; Inland Products Co. vs. Blair, 31 F.2d 867 (4th Cir. 1929); Whitney vs. Commissioner, supra, 13 T.C. at 901.]

Reasonable and good faith reliance upon the advice of counsel after full and fair disclosure of the facts by the taxpayer is a relevant factor in determining whether the taxpayer had reasonable cause to defer his claim of deduction while in pursuit of possible recoupment. [See: Cahn vs. Commissioner, supra, 92 F.2d at 676; cf. Haywood Lumber & Min. Co. vs. Commissioner, 178 F.2d 769, 771 (2d Cir. 1950); and see: 2 Restatement, Torts, §§ 283, 299(d) (1934); 1 Restatement, Agency, §§ 272-282 (1933); Note, 64 Harv. L. Rev., supra, at 347.

Accounting procedures followed by the taxpayer in transactions involved in the claim of loss and any claim for recoupment may be relevant where there is an issue as to good faith. [See: Commissioner vs. Harwick, supra, 184 F.2d 835; Commissioner vs. Peterman, supra, 118 F.2d at 976; cf. Lucas vs. American Code Co., supra, 280 U.S. at 451-452; Lewellyn vs. Electric Reduction Co., 275 U.S. 243, 245, 247 (1927).]

The fact that the taxpayer was successful in whole or in part in pursuing his claim for recoup-

ment is immaterial, if the deduction "in the year taken was based on the exercise of reasonable judgment from the facts then known." [Rhodes vs. Commissioner, supra, 100 F.2d at 970; see: Alison vs. United States, supra, 344 U.S. at 170; Boehm vs. Commissioner, [83] supra, 326 U.S. at 290-291; Commissioner vs. Winthrop, supra, 98 F.2d at 75-76.]

But since the taxpayer "cannot choose the year" [United States vs. Ludey, 274 U.S. 295, 304 (1927)], it is a material circumstance that a loss properly deductible for one taxable year may not be deducted for any later year. As Judge Healy put it in First Nat. Corp. vs. Commissioner, supra, 147 F.2d at 464: "If a taxpayer errs in failing to claim a permissible deduction the error can not be rectified by taking the deduction in a later year * * *. On the other hand a capital loss can not be claimed while there remains a reasonable possibly of recoupment. Losses, to be deductible, must in general be evidenced by completed transactions, fixed by identifiable events. The loss must, within reason, be final and irrevocable."

By parity of reasoning it is a material circumstance that any recoupment following deduction is taxable as ordinary income for the taxable year when received. [Burnet vs. Sanford & Brooks Co., 282 U.S. 359, 365 (1931); Rhodes vs. Commissioner, supra, 100 F.2d at 970.]

And it is the policy of the law, as declared by the Court of Appeals of this Circuit in Douglas Co. L. & W. Co. vs. Commissioner, supra, that: "Claimed

deductions for * * * [84] inchoate losses are not to be encouraged, and therefore the taxpayer ought not to be penalized for deferring his claim for deductions until he has in good faith resorted to reasonable measures for avoiding or minimizing a threatened loss." [43 F.2d at 905.]

Finally it is to be noted that while in case of doubt the tax statutes and regulations thereunder are "construed most strongly against the Government, and in favor of the citizen" [Gould vs. Gould, 245 U.S. 151, 153 (1917)], rulings of the Commissioner of Internal Revenue have "the support of a presumption of correctness" [Welch vs. Helvering, 290 U.S. 111, 115 (1933)], and the burden of proof is clearly upon the taxpayer to establish both the fact and the amount of a deductible loss. [Burnet vs. Houston, 283 U.S. 223, 227 (1931).]

Turning again to the precise question at bar—whether the amended complaint states "a claim upon which relief can be granted" [Fed. Rules Civ. Proc., Rule 12(b)(6), 28 U.S.C.A. 335 (1951)]—it is a material circumstance that under California law plaintiff's claim against the Flood Control District was a chose or "thing in action" which had value and was assignable. [Stapp vs. Madera Canal & Irr. Co., 34 Cal. App. 41, 166 Pac. 823 (1917); Cal. Civ. Code §§ 953, 954.] [85]

If then, as alleged in the amended complaint, plaintiff's physical assets in question, upon being destroyed or damaged in the 1938 flood, were converted ipso facto into a chose or "thing in action" of an amount equal to the diminution in value of

the physical assets destroyed or damaged as a proximate result of the flood, and plaintiff elected to pursue that claim to possible recoupment in later years, it cannot be said as a matter of law that plaintiff suffered in 1938 a loss "not compensated for by insurance or otherwise" within the meaning of § 23(e) of the Internal Revenue Code. [26 U.S.C. § 23(e); Alison vs. United States, supra, 344 U.S. at 170.]

In my opinion the allegations inter alia in the amended complaint that plaintiff "strongly believed and was advised by his attorneys that he could obtain reimbursement for the damages to his property by legal action against the Los Angeles County Flood Control District and in fact had a reasonable chance at the end of the year 1938 to obtain said reimbursement" sufficiently tender an issue of ultimate fact for trial by jury as plaintiff has demanded. [See: Reviser's Notes fol. 28 U.S.C. § 1346, 28 U.S.C.A. 154 (1950).]

The issue thus tendered is whether, in the light of all the surrounding circumstances, plaintiff exercised ordinary business care and prudence in delaying deduction [86] of loss until the taxable year 1946. [Cf. Reading Co. vs. Commissioner, 132 F.2d 306, 310 (3d Cir. 1942).]

This conclusion finds support in the rule that condition of mind may be averred generally [Fed. Rules Civ. Proc., Rule 9(b), 28 U.S.C.A. 316 (1950)], and the holding that the amount of the taxpayer's eventual recoupment is not determinative, but is only one of the surrounding circum-

stances. [Young vs. Commissioner, 123 F.2d 597, 600 (2d Cir. 1941); cf. Boehm vs. Commissioner, supra, 326 U.S. at 290-291, 294-295.]

Accordingly defendant's motion to dismiss the amended complaint is denied.

October 30, 1953.

/s/ WM. C. MATHES,
U.S. District Judge. [87]

[Endorsed]: Filed Oct. 30, 1953.

[Title of District Court and Cause No. 13922.]

ANSWER TO AMENDED COMPLAINT

Come now the defendants, and in answer to the amended complaint, admit, deny and allege:

First Cause of Action

I.

The allegations contained in paragraph I of the First Cause of Action of the amended complaint are admitted except that it is denied that the income taxes assessed and collected in such action were erroneously, wrongfully or illegally so assessed and collected and except that it is denied that the amount of such income taxes assessed and collected in such action was excessive in amount.

II.

The defendants are without information and knowledge sufficient to form a belief as to the truth

of the allegations contained in paragraph II of the First Cause of Action of the amended complaint and they are accordingly denied. [88]

III.

The allegations contained in paragraph III of the First Cause of Action are admitted.

IV.

The allegations contained in paragraph IV of the First Cause of Action are admitted.

V.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph V of the First Cause of Action of the amended complaint and they are accordingly denied.

VI.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph VI of the First Cause of Action of the amended complaint and they are accordingly denied.

VII.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph VII of the First Cause of Action of the amended complaint and they are accordingly denied.

VIII.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph VIII of the First Cause of Action of the amended complaint and they are accordingly denied.

IX.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph IX of the First Cause of Action of the amended complaint and they are accordingly denied.

X.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph X of the First Cause of Action of the amended complaint and they are accordingly denied, except that the second and unnumbered paragraph of said paragraph X is admitted. [89]

XI.

The allegations contained in paragraph XI of the First Cause of Action are admitted.

XII.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph XII of the First Cause of Action of the amended complaint and they are accordingly denied.

XIII.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph XIII of the First Cause of Action of the amended complaint and they are accordingly denied.

XIV.

The allegations contained in paragraph XIV of the First Cause of Action of the amended complaint are denied, except that it is admitted that an income tax deficiency for the calendar year 1948 was assessed against the plaintiffs in the amount of $16,043.95 together with interest thereon of $2,593.41, making a total of $18,637.36 which amounts were paid to the defendant Robert Riddell, Collector of Internal Revenue for the Sixth Collection District of California, on March 2, 1951 and May 11, 1951, respectively.

XV.

The allegations contained in paragraph XV of the First Cause of Action of the amended complaint are denied.

XVI.

The allegations contained in paragraph XVI of the First Cause of Action of the amended complaint are denied.

XVII

The allegations contained in paragraph XVII of the First Cause of Action of the amended complaint are denied, except that it is admitted that on or about August 14, 1951, the plaintiffs filed

with the defendant Robert Riddell, Collector of Internal Revenue for the Sixth Collection District of California, a claim for refund of income taxes paid for the calendar year 1948 in the [90] amount of $18,637.36 plus interest as prescribed by law, but each and every allegation contained in such claim for refund filed by the plaintiffs on August 14, 1951, for the calendar year 1948 is specifically denied, and it is further denied that said claim for refund sets forth substantially the same grounds as are set forth in the amended complaint.

XVIII.

The allegations contained in paragraph XVIII of the First Cause of Action are admitted.

XIX.

The allegations contained in paragraph XIX of the First Cause of Action are denied.

Second Cause of Action

I.

The allegations contained in paragraph I of the Second Cause of Action of the amended complaint are answered in the same manner as the allegations referred to therein were answered as and where they appeared in the First Cause of Action, respectively.

II.

The allegations contained in paragraph II of the Second Cause of Action of the amended complaint are admitted.

III.

The allegations contained in paragraph III of the Second Cause of Action of the amended complaint are denied, except that it is admitted that an income tax deficiency for the calendar year 1949 was assessed against the plaintiffs in the amount of $654.74 together with interest thereon of $46.20 making a total of $700.94, which amounts were paid to the defendant Robert Riddell on or about July 2, 1951.

IV.

The allegations contained in paragraph IV of the Second Cause of Action of the amended complaint are denied.

V.

The allegations contained in paragraph V of the Second Cause of Action [91] of the amended complaint are denied.

VI.

The allegations contained in paragraph VI of the Second Cause of Action of the amended complaint are denied, except that it is admitted that on or about August 24, 1951, the plaintiffs filed with the defendant Robert Riddell, Collector of Internal Revenue for the Sixth Collection District of California, their joint claim for refund for the calendar year 1949 in the amount of $5,951.20 plus interest as prescribed by law, but each and every allegation contained in such claim for refund filed by the plaintiffs on August 24, 1951 for the calendar year 1949 is specifically denied, and it is further denied that said claim for refund sets forth sub-

stantially the same grounds as are set forth in the amended complaint.

VII.

The allegations contained in paragraph VII of the Second Cause of Action of the amended complaint are admitted.

VIII.

The allegations contained in paragraph VIII of the Second Cause of Action of the amended complaint are denied.

Third Cause of Action

I.

The allegations contained in paragraph I of the Third Cause of Action of the amended complaint are answered in the same manner as the allegations referred to therein were answered as and where they appeared in the First Cause of Action, respectively.

II.

The allegations contained in paragraph II of the Third Cause of Action of the amended complaint are denied, except that it is admitted that on or about March 15, 1948, the plaintiff, Earl Callan filed with the defendant Harry C. Westover his income tax return for the calendar year 1947 showing thereon a net income of zero and he paid no income tax for the year 1947 at the time of filing said return.

III.

The allegations contained in paragraph III of the Third Cause of Action of the amended complaint

are denied, except that it is admitted that an income tax deficiency for the calendar year 1947 was assessed against the plaintiff Earl Callan in the amount of $14,044.67 together with interest thereon in the amount of $2,270.23 making a total of $16,-314.90, which amounts were paid to the defendant Robert Riddell on March 2, 1951 and on May 11, 1951, respectively.

IV.

The allegations contained in paragraph IV of the Third Cause of Action of the amended complaint are denied.

V.

The allegations contained in paragraph V of the Third Cause of Action of the amended complaint are denied.

VI.

The allegations contained in paragraph VI of the Third Cause of Action of the amended complaint are denied.

VII.

The allegations contained in paragraph VII of the Third Cause of Action of the amended complaint are denied, except that it is admitted that on or about August 14, 1951, the plaintiff Earl Callan filed with the defendant Robert Riddell a claim for refund for the calendar year 1947 in the amount of $16,314.90 together with interest thereon as prescribed by law, but each and every allegation contained in such claim for refund filed by the plaintiff Earl Callan on August 14, 1951, for the calendar year 1947 is specifically denied, and it is

further denied that said claim for refund sets forth substantially the same grounds as are set forth in the amended complaint.

VIII.

The allegations contained in paragraph VIII of the Third Cause of Action of the amended complaint are admitted.

IX.

The allegations contained in paragraph IX of the Third Cause of Action [93] of the amended complaint are denied.

Fourth Cause of Action

I.

The allegations contained in paragraph I of the Fourth Cause of Action of the amended complaint are answered in the same manner as the allegations referred to therein were answered as and where they appeared in the First Cause of Action, respectively.

II.

The defendants are without information and knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph II of the Fourth Cause of Action of the amended complaint and they are accordingly denied.

III.

The allegations contained in paragraph III of the Fourth Cause of Action of the amended complaint are denied, except that it is admitted that on or about March 15, 1947, the plaintiff Earl Callan

filed his income tax return for the calendar year 1946, with the defendant Harry C. Westover as Collector of Internal Revenue for the Sixth Collection District of California and except that it is admitted that on such return the plaintiff reported a net taxable income for the year 1946 of $32,-428.98 and a tax liability for such year of $13,-400.67, which amount of $13,400.67 the plaintiff Earl Callan paid on or before March 15, 1947 to the defendant Harry C. Westover as such Collector.

IV.

The allegations contained in paragraph IV of the Fourth Cause of Action of the amended complaint are denied.

V.

The allegations contained in paragraph V of the Fourth Cause of Action of the amended complaint are denied.

VI.

The allegations contained in paragraph VI of the Fourth Cause of Action of the amended complaint are denied, except that it is admitted that on or about August 14, 1951, the plaintiff Earl Callan filed with the defendant Robert Riddell, Collector of Internal Revenue for the Sixth Collection District [94] of California, a claim for refund of income taxes paid for the calendar year 1946 in the amount of $13,400.67, but each and every allegation contained in such claim for refund filed by the plaintiff Earl Callan for the calendar year 1946 on August 14, 1951, is specifically denied, and it is

further denied that said claim for refund sets forth substantially the same grounds as are set forth in the amended complaint.

VII.

The allegations contained in paragraph VII of the Fourth Cause of Action of the amended complaint are admitted.

IX.

The allegations contained in paragraph IX of the Fourth Cause of Action of the amended complaint are denied.

As a second, separate and further defense to each and every cause of action, these defendants state that each and every cause of action of the amended complaint should be dismissed because it fails to state a claim from which relief can be granted.

As a third, separate and alternative defense to each and every cause of action, these defendants state the amended complaint should be dismissed on the ground that this court lacks jurisdiction of the subject matter for the reason that the grounds for refund stated in the amended complaint are different grounds from those stated in the claims for refund filed.

As a fourth, separate and alternative defense, these defendants move the court to strike from each and every cause of action of Plaintiff's amended complaint the following redundant, immaterial and impertinent matter contained in Paragraph VII

of the First Cause of Action of the amended complaint and repeated and repleaded by reference in the Second and Third Causes of Action: [95]

"From and after the time of said flood and continuously thereafter during the year 1938, plaintiff strongly believed and was advised by his attorneys that he could obtain reimbursement for the damages to his property by legal action against the Los Angeles County Flood Control District and in fact had a reasonable chance at the end of the year 1938 to obtain said reimbursement and possibly a profit."

Wherefore, the defendants demand judgment that each of the four causes of action of the amended complaint be dismissed and that the defendants be awarded their lawful costs and disbursements herein.

LAUGHLIN E. WATERS,
United States Attorney
EDWARD R. McHALE and
ROBERT H. WYSHAK,
Asst. U. S. Attorneys,
EUGENE HARPOLE,
Special Attorney, Internal Revenue Service
/s/ EDWARD R. McHALE,
Attorneys for Defendants [96]

Affidavit of Service by Mail attached. [97]

[Endorsed]: Filed Nov. 18, 1953.

[Title of District Court and Cause No. 13922.]

STIPULATION OF ISSUES TO BE TRIED

It Is Hereby Stipulated, by and between the parties hereto, through their respective counsel of record, that following are the only issues remaining to be tried:

I. The Year of Loss

It is the contention of the plaintiffs in this action that for income tax purposes, plaintiff Earl Callan's loss originating from damage done by the March 2, 1938, flood was finally and entirely sustained by him in the year 1948 to the extent of the entire amount of such loss. It has been stipulated between plaintiffs and defendant, that, except for any loss which may be held to be properly sustained and deductible in the year 1938, all other loss, if any, which may be held to be sustained by plaintiff Earl Callan shall be deemed to be loss sustained by plaintiff in the year 1948. [98]

Plaintiff contends that none of plaintiff's loss was sustained or deductible in the year 1938. Defendant contends that all of the plaintiff's loss was properly sustained and deductible in the year 1938.

II. The Character of the Loss

If the decision on the first issue is for plaintiff, that the loss was sustained and deductible in 1948, then with reference to each of the following respective portions of plaintiff Earl Callan's loss which

originated from the flood damage to the following classes of assets located at 1740 Riverside Drive, was such portion of his loss attributable to the operation of a business which he, Earl Callan, regularly carried on:

(a) Land at 1740 Riverside Drive?

(b) Buildings and improvements at 1740 Riverside Drive?

(c) Furniture and furnishings at 1740 Riverside Drive?

This determination is necessary under the applicable provisions of Section 122 (d)(5) of the Internal Revenue Code to determine under Local Rule 7(h) the amount, if any, of net operating loss determined for the year 1948 which would become available as a net operating loss carryback to the year 1946.

Defendant contends that each portion of said loss was not attributable to the operation of a business regularly carried on by Earl Callan and, therefore not allowable for net operating loss purposes under Section 122 (d)(5) except to the extent of gross income of plaintiffs not derived from a trade or business.

The issue as to each of the above portions shall be determined separately and entirely. [99]

Dated: January 28, 1955.

/s/ HERBERT S. MILLER,
Attorney for Plaintiffs
LAUGHLIN E. WATERS,
United States Attorney

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division
/s/ EDWARD R. McHALE,
Attorneys for Defendants [100]

[Endorsed]: Filed Jan. 28, 1955.

[Title of District Court and Cause No. 13922.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel of record, without prejudice to the rights of any party herein to introduce additional evidence not inconsistent herewith, and without prejudice to their right to object to the materiality or irrelevancy of any of the facts agreed to, as follows:

I.

This is an action for refund of income taxes for the years 1948 under Paragraph XVI,B, Plaintiffs' Secondary Position, First Cause of Action, and for 1946 under the Fourth Cause of Action, by plaintiffs Earl and Helen Callan, who were husband and wife during those years. All other issues raised by the pleadings in No. 13357 and all other issues raised by the pleadings in the other positions and Causes of Action in No. 13922 have, in effect, been removed as issues by this stipulation.

For the year 1948 they filed a joint income tax

return, and, therefore, the claimed loss deduction which relates in some aspects to physical events occurring in 1938, if allowed, will serve to reduce Earl and Helen Callans' joint income taxes for 1948, and may serve to reduce them for 1946. However, for the purposes of convenience in this stipulation, and because Earl and Helen Callan were not married until 1941, reference in this stipulation hereafter to "plaintiff" or "taxpayer" will be to Earl Callan, whose property was damaged. The plaintiff Helen Callan herself owned no property damaged or destroyed by the 1938 flood. In the event of any recovery for plaintiffs as a result of this action, it shall be allocated to both of them as is proper under the internal revenue laws, in view of their having filed a joint income tax return for 1948.

II.

At all times herein mentioned, plaintiffs were and now are residents of the City of Los Angeles, County of Los Angeles, State of California; that the said place of residence is in the Central Division of the United States District Court in and for the Southern District of California.

III.

On February 27, 1938, and at all times thereafter which are material to this action, plaintiff Earl Callan was the owner of an undivided one-half interest, and no more, in the real estate commonly known as 1740 Riverside Drive, Los Angeles, California, and 1723 Rancho, Los Angeles, California,

together with all improvements, fixtures and appurtenances to said real estate.

IV.

For all purposes of this stipulation, the term "adjusted cost basis," as used herein, shall mean the amount allowable to plaintiff under the internal revenue and income tax laws of the United States as his cost, net after subtraction for depreciation allowed or allowable, for purpose of income tax reporting of transactions and events concerning the respective properties and assets for which such adjusted cost bases are hereinafter stipulated.

V.

At the time of the flood hereinafter referred to, plaintiff had the following respective adjusted cost basis for his said undivided one-half interest in the following properties and assets:

Land at 1740 Riverside Drive—One-half of $11,125.00, or		$ 5,562.50
Improvements, fixtures and appurtenances to the real estate at 1740 Riverside Dr.		24,345.00
$24,345.00, or one-half of $48,690.00 consisting of an undivided one-half of each of the following:		
Landscaping, wall and pumps	$ 4,500.00	
Another wall and entrance	5,872.50	
Swimming pool and dressing rooms	1,800.00	
House	36,517.50	
	$48.690.00	
Total for land and improvements, fixtures and appurtenances at 1740 Riverside Drive, one-half of $59,-815.00, or		$ 29,907.50

VI.

Plaintiff was the sole and separate owner of furniture and furnishings which were located at 1740 Riverside Drive at the time of the flood hereinafter referred to, and that at such time said plaintiff's adjusted cost basis for such furniture and furnishings was $40,765.00.

VII.

Plaintiff owned as his separate property an undivided one-half of various personal clothing, personal jewelry, personal effects and other personal non-business property, which was located primarily on the second floor of the residence building at 1740 Riverside Drive at the time of the flood hereinafter referred to, and that at such time plaintiff's adjusted cost basis for such undivided one-half of said personal clothing, personal jewelry, personal effects and other personal non-business property, was one-half of $7,710.00, or $3,855.00.

VIII.

At the time of the flood hereinafter referred to, plaintiff owned as his separate property, an undivided one-half interest in, and for each such respective undivided interest had the following respective adjusted cost bases for the following properties:

Land at 1723 Rancho, one-half of $5,160.00, or.....$ 2,580.00
consisting of an undivided one-half of each of the following:
Original cost .....$ 3,000.00

Landscaping, Street work, and sprinklers, driveway, and patio improvements	2,160.00	
	$ 5,160.00	
Swimming pool, walls and buildings located on said real estate at 1723 Rancho, one-half of $21,384.00, or		$ 10,692.00
consisting of an undivided one-half of each of the following:		
Swimming pool and dressing room	$ 4,320.00	
Stables	3,150.00	
House	13,914.00	
Total for real estate at 1723 Rancho, as itemized above, one-half of $26,544.00, or		$ 13,272.00

IX.

Plaintiff owned an undivided one-half interest in personal property which was situated at 1723 Rancho at the time of the flood hereinafter referred to and for which at such time, for such undivided interest, he had the following respective adjusted cost bases:

Oriental Rug (½ of $1,350.00) or	$ 675.00
Domestic Rug (½ of $75.00 or)	37.50
Bar and Mirror (½ of $67.50 or)	33.75
Eight (8) Spanish Posters (½ of $486.00) or	243.00
Total (½ of $1,978.50 or)	$ 989.25

At and immediately prior to the time of such flood, the fair market value of plaintiff's interest in each and everyone of the assets described in the stipulation was at least as great as and no greater than the respective adjusted cost basis of plaintiff herein stipulated for his interest in such asset.

X.

On or about the 2nd day of March, 1938, the Los Angeles River overflowed its banks and levees and its normal channel, suddenly, and caused a flood which inundated plaintiff's said real estate at 1723 Rancho and 1740 Riverside Drive and entirely washed away and destroyed all the plaintiff's said swimming pool, walls, buildings, and other real estate improvements, furniture, furnishings, personal clothing, personal jewelry, personal effects and all other personal property at 1740 Riverside Drive and 1723 Rancho, and so damaged plaintiff's property at said locations that the aggregate value of plaintiff's undivided one-half interest in said lands after the flood was only one-half of $4,000.00 or $2,000.00; and that, of said $2,000.00 the value after said flood of the land at 1723 Rancho was $500.00 and that the value of the land at 1740 Riverside Drive was $1,500.00.

XI.

From and at all times after the time of said flood, plaintiff had no insurance or other right to reimbursement for damages caused to his property and assets by said flood, except his rights, if any, against the Los Angeles County Flood Control District.

XII.

On or about May 31, 1938, plaintiff filed a claim against and with said Los Angeles County Flood Control District in the amount of Two Hundred Twenty Thousand Seven Hundred Forty Dollars

($220,740.00), for the purpose of obtaining reimbursement for his aforesaid damages, in addition to other damages sustained by him by reason of said flood. This claim was denied by the Los Angeles County Flood Control District in December 1938. Plaintiff thereupon commenced and, continuously until the time of filing suit, prosecuted preparation and work for the purpose of filing suit for such reimbursement. Plaintiff filed suit in the Superior Court in and for the County of Los Angeles against said Los Angeles County Flood Control District in February, 1939, and continuously and diligently prosecuted the case thereafter. The case was tried before the jury of the Superior Court in and for the County of Los Angeles in the year 1946. In its charge to the Jury the Court instructed the jury with respect to damages in the event that it found the Los Angeles County Flood Control District negligent that the defendant is liable only for the damage approximately caused by its removal of certain protection works from the Los Angeles River and that said defendant is not liable for damages, if any, which would have occurred if said protection works and natural repairing growth had not been removed. The jury brought back a verdict for plaintiff in the amount of $80,000.00. Plaintiff made no motion for a new trial, nor did plaintiff attempt to secure any remedy other than judgment for the amount of said verdict.

XIII.

Said Superior Court entered a judgment in favor

of plaintiff Earl Callan in the amount of $80,000.00 on or about March 27, 1946. The defendant, Los Angeles County Flood Control District filed a motion for a new trial which was granted by said Superior Court on or about May 16, 1946, on the grounds that there was insufficient evidence to justify the verdict of the jury, and the judgment based thereon. Plaintiff in the year 1946 appealed from said Order of the Superior Court granting a new trial to the California District Court of Appeals and the California District Court of Appeals affirmed said order for new trial on October 17, 1947. On December 15, 1947, the Supreme Court of California refused to grant a hearing on plaintiff's appeal from said decision of said District Court of Appeals and the case was remanded to the Superior Court in and for the County of Los Angeles for a complete new trial. The new trial ordered was never held and in the year 1948, plaintiff executed an agreement of settlement and release with the Los Angeles County Flood Control District. Plaintiff's net recovery in said settlement after attorneys' fees and court costs was in the amount of $8,403.05, minus $4,201.53 paid by him to his former wife, or a net recovery to plaintiff of $4,201.53.

XIV.

The amounts alleged by plaintiff to be the taxable net income of plaintiff for each taxable year, before deduction of any part of the loss (or net operating losses, including carrybacks and carryovers) which plaintiff in this action claims as deductible losses, including carrybacks and carry-

overs) in computing his correct taxable income for the respective years by reason of the allegations of the complaint in this action, are the correct taxable net income of plaintiff for such years before subtracting any such deductions.

XV.

Plaintiff's correct net taxable income for each year is the respective amount stipulated in paragraph 13 above minus such amount, if any, found in this action to be deductible, and plus or minus any corollary adjustments provided by Federal internal revenue laws.

XVI.

Plaintiff's true income tax liability for each taxable year in this action should be computed upon the correct net taxable income for such year and that such computation shall be made pursuant to Rule 7(h) of the Federal Rules of Civil Procedure upon determination of the other issues in this action.

XVII.

At such times as plaintiffs have alleged concerning the respective refund claims, plaintiff or plaintiffs alleged in the respective causes of action herein, duly filed with the Collector of Internal Revenue for the Sixth District of California, the defendant Riddell, the respective claims for refund for the respective taxable years in this action in the respective amounts alleged by plaintiffs, with such amended returns and schedules attached and incorporated in said claim, as plaintiffs have al-

leged, claiming the respective plaintiff's or plaintiffs' correct tax liability for such respective years to be in amounts alleged in the complaint, and setting forth as the grounds substantially the same grounds as are set forth in the complaint, as amended herein, for each respective taxable year.

XVIII.

Defendant refuses to refund to plaintiff or plaintiffs the sums demanded in the aforesaid claims for refund, or any portion thereof, for any of the respective taxable years.

XIX.

Earl Callan for the calendar year 1938 duly filed his income tax return. Plaintiff did not deduct upon his 1938 income tax return any part of the loss which plaintiff alleges in this action to have been sustained in any later year or deductible in any later year. Said return reported all his income and deductions with said exception, which deductions were sufficient to disclose upon said return a net loss of approximately $1,700, and therefore, no tax payable for said year.

XX.

The parties reserve all rights of objection and exception on appeal, to the extent such rights exist by law in absence of the stipulation, concerning the verdict, finding of fact, or ruling of law in this action which relates to a holding that the flood damage to plaintiff's property from 1938 was not for income tax purposes a loss properly sustained and deductible in the year 1938.

Subject to the foregoing reservation,

It is hereby stipulation and agreed between the parties that, except for any loss which may be held to be properly in the year 1938 all other loss, if any, which may be held to be sustained by plaintiff shall be deemed to be loss sustained by plaintiff in the year 1948.

The amount of such loss, if any, deductible for the year 1948 as to each asset, shall be the difference between (a) plaintiff's hereinabove stipulated basis for his interest in such assets at the time of said flood, minus any above-stipulated value for his interest in such asset immediately after said flood, and minus (b) the proportionate part of plaintiff's stipulated total net recovery of $4,201.53 in the year 1948. The proportionate part of such recovery allocable to each asset shall be the amount determined under (a) for such asset divided by the total of all amounts determined under (a) for all assets and multiplied by $4,201.53.

XXI.

The parties reserve all rights of objection and exception and appeal, to the extent such rights exist by law in the absence of the stipulation, concerning any verdict, finding of fact or ruling of law in this action, which relates to a holding that any loss deduction for the year 1948 as to any asset damage in said flood was or was not a loss of same in plaintiff's trade or business. In the event any loss is determined with respect to the year 1948, the parties

will compute the amount of the judgment pursuant to Local Rule 7(h) of this Court.

XXII.

In computing net operating loss carrybacks and carryovers, if any, the following classes of income of taxpayer shall be considered as gross income not derived from a trade or business:

(a) dividends; (b) interest; (c) royalties; (d) gains and losses upon the capital gains and loss schedule of taxpayer's returns.

All other income reported by taxpayer in his return shall be considered as gross income derived from the trade or business computing net operating loss carrybacks or carryovers for deductions in other years, if any.

XXIII.

The income tax deficiency for the calendar year 1948 was assessed against the plaintiffs in the principal amount of $16,043.95, together with interest in the sum of $2,593.41, or a total of $18,637.36 which was paid by plaintiffs under protest, to the defendant Robert Riddell, on February 5, 1951.

XXIV.

Any computations under Local Rule 7(h) which may become necessary as a result of a judgment entered in this action shall be based upon the following Federal income tax returns and revenue agent's reports which shall be admitted into evidence and for this purpose:

(1) Income tax return for the year 1946 of Helen

Wahl Callan, bearing stamp "Received March 13, 1947";

(2) Original income tax return for the calendar year 1946 of Earl Callan, bearing stamp "Received March 13, 1947";

(3) Amended Federal income tax return of Earl Callan for the calendar year 1946, bearing stamp "Received, March 15, 1948";

(4) Joint income tax return of Earl and Helen Callan, for the calendar year 1948, bearing stamp "Received, March 14, 1949";

(5) Revenue agent's report of O. R. Anderson, with respect to Earl and Helen Callan for the year 1948, dated August 18, 1950.

XXV

For the purpose of computing deductions for net operating loss purposes under Internal Revenue Code, Section 122(d)(5), the loss of plaintiff Earl Callan, originating from the damage and destruction of the property at 1723 Rancho, including the real estate, improvements, furniture and furnishings, is attributable to the operation of a business which plaintiff Earl Callan regularly carried on.

Dated: This 27 day of January, 1955.

/s/ HERBERT S. MILLER,
Attorney for Plaintiffs.

LAUGHLIN E. WATERS,
United States Attorney,

EDWARD R. McHALE,
Assistant U. S. Attorney,
Chief, Tax Division,
/s/ EDWARD R. McHALE,
Attorneys for Defendants.

[Endorsed]: Filed Jan. 28, 1955.

[Title of District Court and Cause No. 13922.]

DEFENDANTS' REQUEST FOR INSTRUCTIONS

Come now the defendants, Robert Riddell and Harry C. Westover, by and through their attorneys, Laughlin E. Waters, United States Attorney, and Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and request the Court that Instructions number 1 to 15, hereto attached, be given the jury impaneled to try the above entitled cause.

Dated: This 8th day of February, 1955.

LAUGHLIN E. WATERS,
United States Attorney,

EDWARD R. McHALE,
Asst. U. S. Attorney,
Chief, Tax Division,

/s/ EDWARD R. McHALE,
Attorneys for Defendants. [101]

General Civil Instructions of Judge Mathes

Civil Nos. 1, 2, 2B-(Modified—using the word "Government" in place of "Corporation").

3, 4, 5, 6, 9, 15, 16, 16-B, 18, 20-B—as modified in accordance with the form of the special verdict.

Instruction No. 1

There are two possible issues before you for decision; first, whether plaintiffs sustained a loss deductible in 1948 by reason of the March 2, 1938 flood which destroyed the premises at 1740 Riverside Drive, together with building, improvements, furniture and furnishings. Only if you find for the plaintiff on the first issue will it be necessary for you to decide the second which is whether the destruction of the 1740 Riverside Drive property together with furniture and furnishings by the March 2, 1938 flood gave rise to a casualty loss, as defendant contends, or a loss attributable to an operation of a business which Earl Callan regularly carried on, as plaintiff contends.

If you find for the plaintiff on any part of the second issue, you must separately decide the character of the loss with respect to:

(a) land at 1740 Riverside Drive,

(b) buildings and improvements at 1740 Riverside Drive,

(c) furniture and furnishings at 1740 Riverside Drive.

If you find the loss deductible in 1948, your determination as to the character of the loss will deter-

mine whether any part of it is available to the plaintiffs and can be carried back to reduce Earl Callan's 1946 taxes under the net operating loss provisions of the law. [103]

Instruction No. 2

The rejection of plaintiffs' refund claims for overpayment of taxes for the years 1948 and 1946 was made by the Commissioner of Internal Revenue, whose act in rejecting those refund claims is presumed to be correct, and, before plaintiffs are entitled to a refund of any part of any income tax paid by them for the calendar year 1948 or 1946, there must be established by a preponderance of evidence that the Commissioner's action in rejecting those claims was erroneous.

Callan v. Westover, 116 F. Supp. 191, 200 [20-22].

Welch v. Helvering, (1933) 290 U. S. 111, 115.

Instruction No. 3

An income tax deduction is a matter of legislative grace and the burden of clearly showing the right to the claimed deduction is on the plaintiffs.

Callan v. Westover, 116 F. Supp. 191, 196 [1-3].

Interstate Transit Lines v. Commissioner, 319 U. S. 590, 593 (1943). [105]

Instruction No. 4

You are to determine whether plaintiff Earl Callan's claim for reimbursement against the Los An-

geles County Flood Control District for damages due to claimed negligence by the District and which had been denied by the District at the close of 1938 was "compensation by insurance or otherwise" and thus served to postpone the loss until the amount thereof, if any, was finally determined, as plaintiffs contend, or whether said claims for damages were too contingent and uncertain to be treated as compensation by insurance or otherwise for the loss, as defendants contend.

Commissioner v. John Thatcher and Sons, 76 F. 2d 900, 902 (2 Cir., 1935). [106]

Instruction No. 5

The loss of plaintiff Earl Callan was deductible in the year it was evidenced by a closed and completed transaction fixed by an identifiable event and bona fide and actually sustained during the taxable period.

Callan v. Westover, 116 F. Supp. 191, 198.

United States Treas. Reg. 111, Section 29.23 (e)-1(b), 26 CFR Section 29.23(e)-1(b).

Instruction No. 6

Among the factors to be taken into consideration by you in determining when plaintiffs' loss occurred is when the physical damage was sustained.

Commissioner v. Highway Trailer Co., 72 F. 2d 913 (7 Cir., 1934) cert. den. 293 U. S. 626. [108]

Instruction No. 7

The mere existence of an unsatisfied claim for

recovery against the Los Angeles County Flood Control District in favor of the taxpayer is not enough to prevent the loss from being held deductible in 1938.

Callan v. Westover, 116 F. Supp. 191, 196 (7).
United States v. S. S. White Dental Co., 274 U.S. 398, 402. [109]

Instruction No. 8

The taxpayer may not reasonably defer the deduction for loss until some more tax advantageous year by pursuing a tenuous claim for recovery against the Los Angeles Flood Control District.

Callan v. Westover, 116 F. Supp. 191, 198 [11] and cases cited. [110]

Instruction No. 9

You are to determine whether Earl Callan delayed deducting the loss to a year later than 1938 for reasons other than business care and prudence, such as effecting a tax benefit which otherwise would have been useless to him, because plaintiffs are not allowed to pick and choose the year of loss principally to effect the most advantageous tax benefit.

Callan vs. Westover, 116 F.Supp. 191, 199 [15-17].
United States v. Ludey (1927), 274 U. S. 295, 304. [111]

Instruction No. 10

You are to take into account in determining the reasonableness of plaintiff's inaction in not deducting the flood loss in 1938, whether he had net tax-

able income in 1938 against which to offset it, and whether he can be said to have a tax reason for taking the loss in later years. [112]

Instruction No. 11

If a taxpayer deducts his loss in the year of physical destruction and a claim for reimbursement is allowed in a later year by court action or otherwise, the amount reimbursed does not escape tax and the Government does not lose revenue, because the later recover of reimbursement for the earlier loss is included in taxable income in the year of reimbursement to the extent the taxpayer received a tax benefit by the earlier loss deduction.

Callan v. Westover, 116 F. Supp. 191, 199 [18].

Burnet v. Sanford & Brooks Co. (1931), 282 U.S. 359, 365. [113]

* * * * *

Acknowledgment of Service attached. [118]

[Endorsed]: Filed Feb. 8, 1955.

[Title of District Court and Causes 13357, 13922.]

MINUTES OF THE COURT

Date: Feb. 8, 1955, at Los Angeles, Calif. (Same Order in each case.)

Present: Hon. Wm. C. Mathes, District Judge; Deputy Clerk: Edw. F. Drew, 10 a.m.; C. A. Seitz, 3:15 p.m.; Reporter: Don P. Cram; Counsel for Plaintiffs: Herbert S. Miller; Counsel for Defendants: Edw. R. McHale, Ass't U. S. Att'y.

Proceedings: For jury trial on joint trial of the issues.

Attorney McHale makes a statement and moves to dismiss Case No. 13,357-WM Civil. Attorney Miller makes a statement re said motion. Court Orders said motion denied and that Case No. 13,-357-WM trial Case No. 13,922-WM.

Court Orders that a jury be impaneled and trial proceed in Case No. 13,922-WM.

The following jurors, duly impaneled, are sworn to try this cause: 1. Myrtle M. Fewster; 2. Ralph J. Jacoby; 3. John G. Iler; 4. Lloyd W. Oldfield; 5. Grace P. Abbott; 6. David J. Gittleson; 7. Mayer M. Baran; 8. Gertrude H. Kittner; 9. Alice M. Nuttall; 10. Esther B. Rappaport; 11. Kenneth A. Saunderson; 12. Ida Sokol. Alternate Juror: Doyle F. Ziegler.

Attorney Miller makes opening statement to jury in behalf of plaintiffs.

Attorney McHale makes opening statement to jury in behalf of defendants.

At 10:55 a.m. Court admonishes the jurors not to discuss this cause and declares a recess. At 11:10 a.m. court reconvenes herein, and all being present as before, including the jury and alternate juror, and counsel so stipulating.

Earl Callan is called, sworn, and testifies for plaintiffs.

Plfs' Ex. 1-A through 1-H, 2-A through 2-E, 3, 4-A through 4-G, 5-A through 5-G, 6, 7-A through 7-D, are admitted in evidence.

Plf's Ex. 33 (Stipulation of facts filed Jan. 28, 1955) is admitted in evid.

At noon Court reminds the jurors of the admonition heretofore given and declares a recess. At 2 p.m. court reconvenes herein, and all being present as before, including jury and alternate juror, and counsel so stipulating;

Earl Callan resumes testimony in behalf of plaintiff.

Filed defendants' requested jury instructions.

Plf's Ex. 8, 9-A, 9-B, 10, 11, 12, 13, and 14 are admitted in evidence.

At 3 p.m. Court reminds the jurors of the admonition heretofore given and declares a recess. At 3:15 p.m. court reconvenes herein, and all being present as before, including the jury and alternate juror, and counsel so stipulating;

Plf's Ex. 15-A through 15-D are received in evidence.

Plf's Ex. 16 is marked for ident.

Court permits counsel to approach the bench, and out of hearing of the jury, counsel stipulates as to Flood Control System, and counsel withdraw Ex. 16 from evidence.

Plf's Ex. 17 through 32, and 34 through 37, are received in evidence.

At 4:10 p.m. Court admonishes the jurors not to discuss this cause and Orders cause continued to Feb. 9, 1955, 10 a.m., for further jury trial.

EDMUND L. SMITH,
Clerk [119]

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Feb. 9, 1955, at Los Angeles, Calif.

Present: The Honorable Wm. C. Mathes, District Judge; Deputy Clerk: C. A. Seitz; Reporter: Don P. Cram; Counsel for Plaintiff: Herbert S. Miller; Counsel for Defendant: Edw. R. McHale, Ass't U. S. Att'y.

Proceedings: For further jury trial. At 10:20 a.m. court convenes herein, and plaintiff Earl Callan being present, and jury and alternate juror being present, Court orders trial proceed.

The following witnesses are sworn and testify on behalf of Plaintiff: Earl Callan, Harold O. Wright, Michael A. Vargo, Henry M. Lee.

Both sides rest.

At 2:45 p.m. the jury retires, and out of hearing of the jury, Gov't moves for a directed verdict and reserves right of motion thereof, and it is so ordered.

Gov't moves for judgment of acquittal or dismissal on the ground that plaintiffs have shown no grounds for relief. Court denies both motions.

At 2:50 p.m. the jury returns into court.

Court admonishes the jurors not to discuss this cause and excuses them until 9:30 a.m., Feb. 10, 1955. In the absence of the jurors Court and counsel discuss proposed instructions and verdict.

It Is Ordered that further jury trial is continued to 9:30 a.m., Feb. 10, 1955.

EDMUND L. SMITH, Clerk [120]

[Title of District Court and Cause No. 13922.]

MINUTES OF THE COURT

Date: Feb. 10, 1955, at Los Angeles, Calif.

Present: Hon. Wm. C. Mathes, District Judge; Deputy Clerk: C. A. Seitz; Reporter: Don P. Cram; Counsel for Plaintiff: Herbert S. Miller; Counsel for Defendant: Edw. R. McHale, Ass't U. S. Att'y.

Proceedings: For further jury trial. At 9:40 a.m. court convenes herein. It is stipulated and the jury is absent. Court orders trial proceed.

Court and counsel discuss proposed instructions to the jury.

At 10:20 a.m. the jury and alternate juror return into court, and counsel stipulating that the jurors are present, Court orders trial proceed.

Attorney Miller argues to the jury; Attorney McHale argues to the jury; and Attorney Miller argues further to the jury.

At 11 a.m. Court admonishes the jurors not to discuss this cause and declares a recess to 11:10 a.m.

At 11:10 a.m. court reconvenes herein, and all being present as before, except the jury and alternate juror, and counsel stipulating that the jurors are absent, Court orders counsel to proceed.

Court and counsel discuss proposed instructions to the jury.

At 11:15 a.m. Court instructs the jury.

At 11:40 a.m. Court reminds the jurors of the

admonition heretofore given and excuses them. It is stipulated that the jurors are absent.

Court and counsel discuss proposed instructions.

At 11:55 a.m. the jury and alternate juror return into court, and counsel stipulating that the jurors are present, Court orders counsel proceed.

Floyd O. Strong and Elizabeth Bazar are sworn as bailiffs to care for the jury, and Court orders that the jurors be taken to lunch. At 12:20 p.m. the jurors and two bailiffs retire from the Court room.

At 1:50 p.m. the jury and alternate juror return to the jury room and resume deliberation upon a verdict.

At 4:35 p.m. court reconvenes herein, and all being present as before, including counsel for both sides and the jury.

The jury returns its Verdict in open court and said verdict is read by the clerk and ordered filed and entered, to wit: (See Verdict following:)

Court orders the jury discharged, and excused until notified.

Court instructs counsel to present judgment on the verdict in Case No. 13,922-WM and judgment of dismissal in Case No. 13,351-WM on Feb. 14, 1955.

EDMUND L. SMITH,
Clerk [123]

[Title of District Court and Cause No. 13357.]

STIPULATION AND ORDER FOR DISMISSAL WITH PREJUDICE

It Is Hereby Stipulated, by and between the parties hereto, through their respective counsel of record, that the above action may be, and is hereby, dismissed with prejudice, without costs to either party.

Dated: This 15th day of February, 1955.

/s/ HERBERT S. MILLER,
Attorney for Plaintiff

LAUGHLIN E. WATERS,
United States Attorney

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division

/s/ EDWARD R. McHALE,
Attorneys for Defendant

It Is So Ordered this 16th day of February, 1955.

/s/ WM. C. MATHES,
United States District Judge [155]

[Endorsed]: Judgment Entered and Filed Feb. 16, 1955.

In the District Court of the United States, Southern District of California, Central Division

No. 13922-WM—Civil

EARL CALLAN and HELEN W. CALLAN,
Plaintiffs,

vs.

ROBERT RIDDELL and HARRY C. WESTOVER,
Defendants.

JUDGMENT

Pursuant to the pleadings of the parties, the Stipulation of Facts filed January 28, 1955, by the parties, and the Stipulation of Issues to be Tried by the parties filed on January 28, 1955, this cause came on for trial before the Court and a jury duly impaneled on the 8th day of February, 1955, for the trial of issues set forth in a form of Special Verdict [Fed. Rules Civ. Proc., Rule 49(a)] stipulated by the parties to this action through their counsel of record; Herbert S. Miller, Esq. appearing as counsel for plaintiffs, and Laughlin E. Waters, United States Attorney for the Southern District of California, and Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, for said District, appearing as counsel for the defendants; and the trial having commenced on the 8th day of February, 1955, before the Court and said jury, and during the trial of said cause, testimony having [156] been adduced on the part of plaintiff by plaintiffs' witnesses, and by defendants through cross-examination of plaintiffs' witnesses, and exhibits admitted on behalf of the respective parties,

and said testimony and exhibits and trial having continued to and including the 9th day of February, 1955; and the parties having rested on the 9th day of February, 1955, and motions of defendants for dismissal under Fed. R. Civ. P. 41(b) and for a directed verdict under Fed. R. Civ. P. 50(a) having been timely made and denied, and renewed at the close of the case and denied, the trial was continued to the 10th day of February, 1955, and the respective counsel having argued to the jury on the 10th day of February, 1955, the Court thereafter instructed the jury on the 10th day of February, 1955; and

On the 10th day of February, 1955, after the instructions of the Court, said cause was submitted to the jury for its consideration and verdicts upon the issues set forth in said stipulated form of verdicts; and after consideration thereof, the jury thereafter on said 10th day of February, 1955, having returned into court, and after presenting its verdicts, which were read by the Court, the Court ordered the verdicts as presented and read, filed and entered, and is as follows: [157]

[Title of District Court and Cause No. 13922-WM.]

SPECIAL VERDICT

We, the Jury in the above-entitled cause, unanimously find the answer to Question No. 1, to-wit:

Question 1: "Was plaintiff Earl Callan's loss from the March 2, 1938 flood finally and entirely sustained and deductible by him in 1938 or 1948?"

Answers: (1938) No; (1948) Yes.

(If the first question is answered "1938," question No. 2 need not be answered.)

(If question No. 1 is answered "1948", then you must answer each part of question No. 2 "Yes" or "No".)

We, the Jury in the above-entitled cause, unanimously find the answer to Question No. 2, to-wit:

Question 2: "Was any portion of Earl Callan's loss attributable to the operation of a business regularly carried on by him on March 2, 1938, at 1740 Riverside Drive with respect to the following property there located:

(a) "To the land?"

Answers: (No).....; (Yes) Yes.

(b) "To the buildings and improvements?"

Answers: (No) ....; (Yes) Yes.

(c) "To the furniture and furnishings?"

Answers: (No) No; (Yes) .....

Dated this 10th day of February, 1955.

/s/ Kenneth R. Saunderson,
Foreman of the Jury [158]

And, the parties having under Local Rule 7(h) stipulated as to the computation of the amount of the judgment to be entered, said stipulation having been filed herein,

Now Therefore by virtue of the law and by reason of the premises aforesaid,

It Is Hereby Ordered, Adjudged and Decreed:

That the plaintiffs, Earl Callan and Helen W. Callan, do have and receive from Robert A. Riddell, Collector of Internal Revenue, the sum of Eighteen Thousand Six Hundred Thirty Seven and

36/100 Dollars ($18,637.36) and interest thereon at the rate of six per centum per annum thereon from February 5, 1951, until a date preceding payment by not more than thirty (30) days, such date to be determined by the Commissioner of Internal Revenue of the United States, together with their costs to be taxed by the Clerk of this Court in the sum of $....., and

It Is Hereby Further Ordered, Adjudged and Decreed:

That the plaintiff Earl Callan do have and receive from defendant Harry C. Westover, former Collector of Internal Revenue, the sum of Four Thousand Seven Hundred Fifteen and 59/100 Dollars ($4,715.59) and interest thereon at the rate of six per centum per annum, from March 15, 1949, until a date preceding payment by not more than 30 days, such date to be determined by the Commissioner of Internal Revenue of the United States.

Dated this 16th day of February, 1955.

/s/ WM. C. MATHES,
United States District Judge

Approved as to Form pursuant to Local Rule 7(a) this 16th day of February, 1955.

/s/ Herbert S. Miller, Attorney for Plaintiffs.
Laughlin E. Waters, U. S. Attorney
Edward R. McHale, Asst. U. S. Attorney, Chief Tax Division
/s/ Edward R. McHale, Attorneys for Defendants

[Endorsed]: Judgment Entered and Filed Feb. 16, 1955.

[Title of District Court and Cause No. 13922.]

MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT TO THE CONTRARY, OR IN THE ALTERNATIVE, MOTION FOR PARTIAL NEW TRIAL

Defendants, Harry C. Westover and Robert Riddell, through their counsel for record, move the Court as follows:

I. For an order setting aside Special Verdicts to Question No. 1, Question No. 2(a) and Question No. 2(b), and setting aside judgment heretofore entered in the above entitled action and for judgment in accordance with their previous motions for directed verdicts on the grounds that the Court erred in denying the motion of defendants for directed verdicts for the following reasons:

A. With respect to the Special Verdict on Question No. 1, under the facts and the law, the loss of plaintiffs was final and completely sustained, fixed and known in amount, and the property was physically destroyed, in the year 1938, and the loss was not reimbursed or reimbursable by insurance or otherwise.

B. With respect to the Special Verdicts on Questions No. 2(a) and 2(b), on the facts and the law, it clearly appears that [160] the property at 1740 Riverside Drive, land, buildings and improvements, were used by plaintiff, Earl Callan, as the personal residence of himself and family up to the time of the flood, and that he had abandoned it as

such or he had not evidenced an intent to abandon as such, both elements of abandoning being necessary before said property or either portion thereof, can be treated as property used in a business regularly carried on by him for net operating loss purposes.

C. With respect to Special Verdicts on Questions No. 2(a) and 2(b), under the law the net operating loss provisions of the Internal Revenue Code are not available to plaintiffs, because the loss occurred in 1938 and only was postponed to 1948 because of the finding of the jury, in effect, that it was reimbursed in 1948, and thus sustained in 1948, whereas, the provisions of the Internal Revenue Code permitting the carry-back of net operating loss of businesses regularly carried on were not in effect in 1938, and when later enacted, were made specifically inapplicable to years prior to 1939.

D. With respect to Special Verdicts on Questions No. 2(a) and 2(b), the verdicts are contrary to instruction 13-A, in that the evidence clearly and undisputedly shows occupancy of the property by Earl Callan as a residence, which reason for occupancy is either other than, or additional to, occupancy for business operational purposes, and for that reason, judgment entered on said questions is erroneous and should be set aside and entered for defendants.

II. In the alternative, defendants move the Court to set aside the Special Verdict with respect to Questions No. 1, No. 2(a) and No. 2(b) and

grant a new trial of this action as to said questions only on the following grounds:

A. Insufficiency of the evidence to justify the verdict or judgment thereon, in the following respects: [161]

1. With respect to the Special Verdict on Question No. 1, the weight of the evidence clearly shows that the loss was completely sustained and deductible in 1938 and not reimbursed by insurance or otherwise and the jury verdict is contrary to the weight of the evidence and erroneous.

2. With respect to Questions No. 2(a) and 2(b) the evidence undisputedly shows that Earl Callan and his wife used the property at 1740 Riverside Drive as a residence up to the time of the flood and had not intended to abandon it as such or had not in fact abandoned it as such at the time of the flood and thus, it could not be property used in a business regularly carried on by Earl Callan, and the jury verdict is contrary to the evidence and erroneous.

3. With respect to Special Verdicts on Questions No. 2(a) and 2(b) the evidence incontrovertibly shows that Earl Callan and his household occupied the property as his residence up to the time of the flood, which reason for occupancy is either other than, or additional to, occupancy for business operational purposes, and for that reason, verdict for plaintiffs on said questions is contrary to the Court's Instruction 13-A, and the evidence is insufficient to support said verdicts.

B. Errors in law occurring at the trial:

1. The giving of the instructions objected to by the defendants, Numbers 11, sentence commencing line 8, 11-A, [162] first paragraph and sub-parts (2), (3) and (4), first paragraph of 12, 13, fourth paragraph of 14, and the additional comments and instructions of the Court, objected and excepted to just before the jury retired, bearing on Question No. 1, with respect to the year the loss was sustained and deductible.

2. The failure to give instructions requested by the defendants, Numbers 4, 5, 12, 13, 14, 15, 18, 19, 20.

Dated: February 21, 1955.

LAUGHLIN E. WATERS,
United States Attorney

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division

/s/ EDWARD R. McHALE,
Attorneys for Defendants [163]

[Endorsed]: Filed February 21, 1955.

[Title of District Court and Cause No. 13922.]

ORDER DENYING DEFENDANTS' MOTION FOR JUDGMENT NOTWITHSTANDING VERDICT TO THE CONTRARY, AND DENYING DEFENDANTS' ALTERNATIVE MOTION FOR PARTIAL NEW TRIAL

This cause came on to be heard upon a motion of the defendants for an order setting aside Special Verdicts to Question No. 1, Question No. 2(a) and Question 2(b), heretofore rendered by the jury in this cause, and setting aside judgment heretofore entered in this cause and for judgment in accordance with defendants' previous motions for directed verdicts, and also upon an alternative motion of the defendants to set aside said Special Verdict with respect to said Questions No. 1, No. 2(a) and No. 2(b) and to grant a new trial of this action as to said questions only.

Defendants and plaintiffs have each submitted memoranda with respect to their respective positions concerning said motions, and have each waived oral argument thereon.

The court has considered each of said motions, and is of the opinion that each of said motions should be overruled.

It is therefore ordered that the motions of the defendants [168] for an order setting aside Special Verdicts to Questions No. 1, Question No. 2(a) and Question 2(b) and setting aside judgment hereto-

fore entered in this cause and for judgment in accordance with defendants' previous motions for directed verdicts, and defendants' alternative motion to set aside said Special Verdict with respect to said Questions No. 1, No. 2(a) and No. 2(b), and to grant a new trial of this action as to said questions only, be and they are overruled and denied.

Ordered, this the 5th day of March, 1955.

/s/ WM. C. MATHES,
United States District Judge

Approved as to form March 3, 1955:

/s/ Herbert S. Miller, Attorney for Plaintiffs.
Laughlin E. Waters, U. S. Attorney; Edward R. McHale, Asst. U. S. Attorney, Chief, Tax Division. Signed by Edward R. McHale, Attorneys for Defendants. [169]

Affidavit of Service by Mail attached. [170]

[Endorsed]: Filed March 7, 1955.

[Title of District Court and Cause No. 13922.]

NOTICE OF APPEAL

To the Above Named Plaintiffs and to Their Attorney, Herbert S. Miller, 250 South Beverly Drive, Beverly Hills, California:

You, and Each of You, Are Hereby Advised that the defendants, Robert Riddell and Harry C. Westover, do hereby appeal to the United States Court

of Appeals for the Ninth Circuit from the final judgment entered February 16, 1955, in the above action.

Dated: This 15th day of April, 1955.

LAUGHLIN E. WATERS,
United States Attorney
EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division
/s/ EDWARD R. McHALE,
Attorneys for Defendants [171]

Affidavit of Service by Mail attached. [172]

[Endorsed]: Filed April 15, 1955.

[Title of District Court and Cause No. 13922.]

MOTION FOR EXTENSION OF TIME TO DOCKET CAUSE ON APPEAL AND ORDER

Comes Now the defendants-appellants, and move the Court to extend the time to docket the above entitled appeal from the final judgment entered February 16, 1955, 50 days under Federal Rule of Civil Procedure 73(g) for the reason that the Solicitor General of the United States has not yet determined whether an appeal should be taken.

Dated: This 20th day of May, 1955.

LAUGHLIN E. WATERS,
United States Attorney

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division

ROBERT H. WYSHAK,
Asst. U. S. Attorney

/s/ ROBERT H. WYSHAK,
Attorneys for Defendants-Appellants [173]

ORDER

Good Cause Appearing Therefor:

It Is Hereby Ordered that the time within which to file the record and docket the above entitled appeal from the final judgment in favor of plaintiffs entered February 16, 1955, in the United States Court of Appeals for the Ninth Circuit be, and the same hereby is, extended to and including July 14, 1955.

Dated: May 20, 1955.

/s/ LEON R. YANKWICH,
United States District Judge

Presented by:

/s/ Robert H. Wyshak, Asst. U. S. Attorney

Affidavit of Service by Mail attached. [175]

[Endorsed]: Filed May 20, 1955.

[Title of District Court and Cause No. 13922.]

APPELLANTS' STATEMENT OF POINTS

Come Now the appellants, Robert Riddell and Harry C. Westover, pursuant to Rule 75 of the Federal Rules of Civil Procedure, and state that they intend to rely upon the following points in the appeal of the above entitled case:

1. The District Court erred in denying appellants' motion to dismiss the amended complaint;

2. The District Court erred in denying appellants' motion for directed verdicts on question No. 1;

3. The District Court erred in instructing the jury (Tr. lines 14-19), to wit:

"The law permitted plaintiff Earl Callan nonetheless to delay claiming a tax deduction for the loss while pursuing his claim against the Flood Control District, if [179] to do so would be the exercise of ordinary business care and prudence under all the surrounding circumstances."

4. The District Court erred in instructing the jury (Tr. 52, lines 2-10), to-wit:

"If the jury should find from the evidence, as plaintiffs contend, that plaintiff Earl Callan did exercise ordinary business care and prudence in delaying deduction of the loss in question for income tax purposes until his claim against the Los Angeles County Flood Control District was finally settled in 1948, then the jury should find that the loss for income tax purposes was not finally and

entirely sustained, and so did not become properly deductible, until the year of settlement—the year 1948."

5. The District Court erred in instructing the jury (Tr. 54, lines 19-23), to-wit:

"* * * you have two years here, 1938 and 1948, and if you find that the plaintiff exercised reasonable care, business care and prudence in postponing the loss until 1948, he is entitled to deduct it whether this is a residential property or a business property."

6. The District Court erred in submitting to the jury the question (Tr. 58-59), to-wit:

"Question 1: 'Was plaintiff Earl Callan's loss from the March 2, 1938 flood finally and entirely sustained and deductible by him in 1938 or 1948?'"

7. The District Court erred in instructing the jury (Tr. 59, lines 7-11), to-wit:

"So, you are called upon to find, under the instructions, whether plaintiff Earl Callan acted with reasonable business care and prudence in postponing claiming the deduction from 1938 when the physical loss occurred [180] until 1948 until after he settled his claim finally with the Flood Control District."

8. The District Court erred in leaving the issue as to the year in which the loss is deductible to the jury as a question of fact, and in instructing the jury that they should consider, along with other surrounding circumstances: the date of the physical loss; and whether the taxpayer made a full and fair disclosure of the facts to an attorney and

thereafter reasonably and in good faith followed and relied upon his advice; and the success or lack of success of the prosecution of his tort claim; and whether the taxpayer prosecuted his tort claim in good faith that he had a reasonable chance of recovery.

9. The District Court erred in not instructing the jury that where, as in this case, a physical loss has occurred which is not compensated for by insurance, the fact that the taxpayer asserts a disputed tort claim does not postpone the year in which the loss is to be taken; that a disputed tort claim is too contingent to warrant such postponement.

10. The District Court erred in not directing a verdict for the defendants on the issue as to the year in which the loss is deductible.

11. The District Court erred in not directing the jury to find that the loss is deductible only for 1938.

12. The District Court erred in not granting defendants' motion for judgment notwithstanding the verdict and for partial new trial.

13. The District Court erred in entering judgment for the plaintiffs.

14. The District Court erred in denying defendants' motion for judgment of dismissal under Rule 41(b) at the close of plaintiffs' case. (Tr. 7, February 9, 1955). [181]

15. The District Court erred in failing to give defendants' proposed instruction No. 4.

16. The District Court erred in failing to give defendants' proposed instruction No. 5.

Dated: July 1, 1955.

LAUGHLIN E. WATERS,
United States Attorney
EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division
/s/ EDWARD R. McHALE,
Attorneys for Defendants-Appellants [182]

[Endorsed]: Filed July 1, 1955.

[Title of District Court and Cause No. 13922.]

ACKNOWLEDGMENT OF RECEIPT OF SERVICE

Receipt of service of the following documents is hereby acknowledged:

1. Appellants' Designation of Contents of Record on Appeal; and
2. Appellants' Statement of Points to be Relied Upon on Appeal.

Dated: July 1, 1955.

HERBERT S. MILLER,
/s/ By HERBERT S. MILLER,
Attorney for Plaintiffs-Appellees [183]

[Endorsed]: Filed July 5, 1955.

[Title of District Court and Cause No. 13922.]

STIPULATION REGARDING CONTENTS OF RECORD ON APPEAL

It Is Hereby Stipulated and Agreed by and between the parties hereto, through their respective counsel of record, without prejudice to any of the other rights of the parties in this action, that there shall be excluded from the contents of the record on the appeal herein:

1. Defendants' Request for Instructions No. 16 and 17, filed February 9, 1955; and

2. Page 20, line 7 through Page 22, line 17, both inclusive, and Page 31, line 6 through Page 42, line 4, both inclusive, of the 63 page Reporter's Partial Transcript of Proceedings, February 9 and 10, 1955; and

3. The Amended Complaint for Recovery of Taxes and Interest in Case No. 13357-WM, Earl Callan Plaintiff vs. Harry C. Westover, Defendant; and it is hereby stipulated that, with respect [184] to the issues on appeal herein, said Amended Complaint in Case No. 13357-WM is substantially the same, in all particulars material to this appeal, as the Amended Complaint of Plaintiffs herein.

Dated: September 11, 1955.

LAUGHLIN E. WATERS,
United States Attorney
EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division

/s/ EDWARD R. McHALE,
Attorneys for Defendants and Appellants

/s/ HERBERT S. MILLER,
Attorneys for Plaintiffs and Appellees [185]

[Endorsed]: Filed July 11, 1955.

[Title of District Court and Cause No. 13922.]

CERTIFICATE OF CLERK

I, John A. Childress, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered 1 to 187, inclusive, contain the original

Complaint for Recovery;

Notice of Motion to Dismiss;

Order on Defendants' Motion to Dismiss;

Notice of Motion and Motion to Dismiss;

Amended Complaint for Recovery of Taxes and Interest (13357-WM);

Stipulation and Order Allowing Amendment of Complaint;

Stipulation and Order for Submitting Motion to Dismiss, etc.;

Order on Motion to Dismiss;

Memorandum of Decision (13357-WM);

Answer to Amended Complaint;

Stipulation of Issues to be Tried;

Defendants' Request for Instructions; 1 through 15, incl.;

Instructions 16 and 17;

Instructions to the Jury;

Special Verdict;

Certificate of Probable Cause;

Stipulation and Order for Dismissal with Prejudice;

Judgment;

Motion for Judgment Notwithstanding Verdict to the Contrary, etc.;

Order Denying Defendants' Motion for Judgment Notwithstanding, etc.;

Notice of Appeal;

Motion for Extension of Time to Docket Cause on Appeal;

Appellants' Designation of Contents of Record on Appeal;

Appellants' Statement of Points to be Relied Upon on Appeal;

Acknowledgment of Receipt of Service;

Stipulation Regarding Contents of Record on Appeal;

Appellees' Designation of Contents of Record on Appeal; which, together with a full, true and correct copy of the Minutes of the Court on June 11, 1952, Oct. 13, 1952, Oct. 15, 1952, Sept. 28, 1953, Oct. 1, 1953, Feb. 8, 1955, Feb. 9, 1955 and Feb. 10, 1955; and two vols. of Reporter's Transcript of Proceedings on Feb. 9 and 10, 1955 (one with pages 1-14 and one with pages 1-63); one vol. of Reporter's Transcript of Proceedings on Feb. 10, 1955

(pages 1 to 17); together with Plaintiffs' exhibit 33; all in said cause, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fee for preparing the foregoing record amount to $2.00, the sum of which has not been paid.

Witness my hand and the seal of said District Court, this 12th day of July, 1955.

[Seal] JOHN A. CHILDRESS,
Clerk

In the United States District Court for the Southern District of California, Central Division

No. 13922-WM Civil

EARL CALLAN and HELEN W. CALLAN,
Plaintiffs,

vs.

ROBERT RIDDELL, Etc., Defendant.

TRANSCRIPT OF PROCEEDINGS
(Partial)
Los Angeles, California, February 9, 1955

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiffs: Herbert S. Miller, 250 So. Beverly Dr., Beverly Hills, Calif. For the Defendant: Laughlin E. Waters, United States Attorney, by Edward R. McHale, Ass't U. S. Attorney.

The Court: Is it stipulated, gentlemen, the jury is absent?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated, your Honor.

The Court: This is a hearing pursuant to Rule 51 of the Federal Rules of Civil Procedure. Rule 51 provides that at the close of the evidence or at such earlier time during the trial as the Court reasonably directs, any party may file written requests that the Court instruct the jury on the law as set forth in the requests. The Court shall inform counsel of its proposed action upon requests prior to their argument to the jury. The Court will instruct the jury after the arguments are completed. No party may assign as error the giving or failure to give an instruction unless he objects to before the jury retires to consider its verdict, saying distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury.

Now, it is my practice, gentlemen, to save sending the jury out needlessly before the case is given to them, that after I have completed the instructions, to turn to counsel and ask if counsel on either side have any matter to take up before the jury retires, and if both of you say no, that you have nothing to take up, I will consider that you do not have any objection that you wish to record to the instructions in the absence of the jury and will not excuse the jury, but will give them the case and permit them to retire to deliberate forthwith upon their verdict.

Is that procedure agreeable to both of you?

Mr. Miller: Yes, Your Honor.

Mr. McHale: Yes, Your Honor. I want to state to the Court that I understand your Honor has, so to speak, made the law on the case in his opinion heretofore and I am going to make exceptions just to preserve the record in this case.

The Court: Then I will plan to excuse the jury before giving them the final instructions. Then either of you may record any objection at that time which you have to the instructions.

Now, each of you has a copy of the instructions, with the exception of those on the second issue, as to whether or not the property was used primarily for business purposes.

As to those instructions, I will advise you orally and will give you copies by tomorrow morning of the instructions I propose to give. I will advise you orally now, however, so that you may be informed well in advance of the arguments. As to the others, a copy of which you have, that is the Court's proposal, the Court's proposed action on your request.

Now, I will hear any suggestion that either of you has or objection, criticism of any instruction that I propose to give, or whether it can be properly eliminated. That is always an admirable thing to do. Instructions in every case are far too long, I think.

Mr. Miller: If the Court please, I will make a few comments.

The Court: What is the first number you have some question about?

Mr. Miller: Instruction 11(b), your Honor.

The Court: Do you have 11(c)?

Mr. Miller: Yes, I also have 11(c).

The Court: 11(c) should probably be considered in connection with 11(b).

Mr. McHale: Your Honor, I seem to have two copies of 11(c) which are somewhat different.

The Court: Very well. One reads, "The mere existence of an unsatisfied claim * * *"

Mr. Miller: That is 11(b), your Honor.

The Court: It is now.

Mr. McHale: No. I have two copies of 11(c) that are somewhat alike, but I think perhaps one was an earlier draft because it isn't as clear as the other.

The Court: Very well.

Mr. McHale: They are not quite alike, but they are essentially the same thing.

The Court: The latest addition ends in 1948.

Mr. McHale: Yes. I assumed the other one was an earlier draft.

The Court: You may hand it to the clerk. It is probably an earlier draft.

What is your objection to 11(b), Mr. Miller?

Mr. Miller: Your Honor, the words, "The mere existence of an unsatisfied claim for recovery against the Los Angeles County Flood Control District is not enough to prevent the loss from being deducted in 1938 * * *" It seems to me——

The Court: "* * * is not enough in itself," I suppose it should be.

Mr. Miller: This was more than a claim. There was testimony about a claim being filed as a preceding condition to the suit that was brought there.

The Court: That is an unsatisfied claim even though it is in litigation, isn't it?

Mr. Miller: I think the jury might construe the word "claim" to refer to the fact that there was a claimed filed and it was denied by the County, which is not the whole substance of the stipulated rights that——

The Court: Well, we might put, "The mere existence of a claim or a suit for recovery * * *"

"Mere existence of a claim against or a suit for recovery * * *"

Mr. Miller: Could we say, Your Honor, "an insubstantial" or "unsubstantial"?

The Court: You don't want to say it is an "unsubstantial claim," do you? That refers to amount. The amount is of no importance, is it?

Mr. Miller: This is just the problem——

The Court: Substance on the merits.

"The mere existence of a claim or suit for recovery * * *" if you want.

Mr. Miller: "Without substantial possibilities of success." Isn't that correct, your Honor? Isn't that what the intent of the instruction is, or am I wrong?

The Court: It is like saying in a negligence action the mere happening of the accident does not prove the negligence. Or the mere existence of a claim or suit for recovery against the Los Angeles County Flood Control District is not enough in itself—in and of itself——

Mr. Miller: Yes, that would be all right.

The Court: How would that be?

Mr. Miller: That would be all right.

The Court: "* * * to prevent the loss from being deductible only in the year 1938."

I suppose it is clear enough just to say "deductible."

Now, any other objection to 11(b)?

Mr. Miller: Well, in connection with the next paragraph, which says, "By pursuing unreasonably a claim for recovery against the Flood Control District," seems to me that might be inferred by the jury as a statement by the Court that the taxpayer was pursuing an unreasonable claim by reason of the fact that the Flood Control District is specifically named.

The Court: Let's see if we can't improve that first sentence.

"Is not in and of itself", it seems to me it might be better to say it affirmatively—"It is not enough in and of itself to warrant the postponement of the deduction to some years subsequent to 1938——"

"——to some later year subsequent to 1938."

Mr. Miller: All that counsel for plaintiff has in mind with reference to that paragraph, your Honor, is that it not be construed by the jury as a statement by the Court that all the——

The Court: Now, you are talking about the second paragraph. I am still on the first one. I have your point about the——

Mr. Miller: In other words, as long as the jury understands that if the taxpayer has a substantial claim that he may recover on, that it is enough to warrant the postponement of the loss. That, your Honor, I think would be satisfactory. But the state-

ment of an instruction that because there was only a lawsuit, it is obvious all the plaintiff had a lawsuit to recover——

The Court: "Not enough in and of itself."

Mr. Miller: It must be a good one, in other words.

The Court: It doesn't even have to be a good one. You don't want me to tell them it has to be a good one. The plaintiff in good faith believes it is a good one; he reasonably and in good faith believes it.

Mr. Miller: That is right.

The Court: He believes it is meritorious.

What do you think of changing that first sentence?

That's taken from one of your requests.

Mr. McHale: Yes, your Honor; which was taken from your Honor's opinion, practically.

The Court: Do you gentlemen think the jury will understand if we say, "The mere existence of a claim or suit for recovery against the Los Angeles County Flood Control District is not in and of itself to prevent loss from being deductible in 1938"?

Mr. Miller: I think, your Honor, if the order of the instruction were changed to place it as a part of Instruction 11(a), between the first and second paragraphs of 11(a), that paragraph as written would be satisfactory.

The Court: Let's don't bother 11(a) unless we have to. That means a great deal more stenographic work, and those are all differences of opinion.

Mr. McHale: I think the paragraph is clear, your Honor.

The Court: Very well.

Then the next paragraph reads, "The taxpayer may not reasonably defer the deduction for loss until some more tax-advantageous year by pursuing unreasonably a claim for reimbursement for his loss."

Does that meet your objection, Mr. Miller?

Mr. Miller: Yes, your Honor.

The Court: "A claim for possible reimbursement of his loss"—reimbursement of his loss.

Mr. Miller: "For his damage."

The Court: "For his loss," isn't it?

Mr. Miller: For tax purposes I thought your Honor ruled in a previous opinion it was not closed and completed loss until the action for reimbursement had been determined.

The Court: It may or may not be. It depends upon whether the claim for reimbursement is one that can reasonably be precluded under the circumstances, such as to warrant keeping the claim open.

I didn't set up this standard. The Supreme Court —I had another view until I—as you know,——

Mr. McHale: Yes, your Honor, I know.

The Court: It seems to me this is a very unpredictable standard that is unsatisfactory both to the Government and the taxpayer. "Claim for possible reimbursement for his loss."

Then is the third paragraph of 11(b) all right?

Mr. Miller: Yes, sir.

Instruction 11(d), Your Honor.

The Court: 11(d)?

Mr. Miller: Yes, sir, (d).

The problem here, it seems to me, is that the in-

struction implies that if plaintiff took into account the tax consideration——

The Court: 11(d)?

Mr. Miller: Yes, your Honor: It says: "That is to say, the jury may determine whether as the Government here contends, Earl Callan delayed deducting the loss in question to a year later than 1938 for reasons other than business care and prudence such as gaining a tax benefit which otherwise would have been useless to him, since a taxpayer is not allowed to pick and choose the year of loss for the sole purpose of gaining the most advantageous tax benefit."

We don't have any quarrel with the rule that the taxpayer may not pick and choose the year of loss. The problem is that the plaintiff could have properly, so we see it, delayed the deduction to a later year because he had a substantial right to recovery or because they appeared substantial by——

The Court: You confuse me. If you say, "I think this instruction should be amended to read as follows," then I will know what you are speaking about. But don't argue the reasons for it until we decide what change you wish made, Mr. Miller.

What objection do you have to it? This is 11(d), now.

Mr. Miller: Yes. If we put the word "only" after the word "1938," in quoting that last paragraph 11(d), it would more nearly express what I think.

The Court: I didn't understand that, now. Would you do that again?

Mr. Miller: If we said, "That is to say, the jury may determine whether, as the Government here

contends, that Earl Callan delayed deducting the loss in question to a year later than 1938 only for reasons other than business care and prudence, such as gaining the tax benefit, which otherwise would have been useless to him."

The Court: There might have been other reasons.

Mr. Miller: The point is, Your Honor, he may have had very good business reasons for feeling that he would recover and for not taking the loss, and yet he may also have considered the——

The Court: "Solely for reasons other than——"

Mr. Miller: That is right.

The Court: You don't want to say "only for reasons other than business care and prudence——"

"Such as for the sole purpose of gaining a tax benefit."

Mr. Miller: Yes.

The Court: Is that all right?

Mr. McHale: I think that too unduly restricts it, Your Honor, by putting the word "sole" in there.

The Court: Well, he might have a mixed purpose, might he not?

Mr. McHale: That is right there but I think the tax benefit is the major purpose. He may have other reasons.

Mr. Miller: If his other reasons were good reasons for delaying——

The Court: "Such as for the primary purpose."

Mr. Miller: Your Honor, I think if he had good, valid business reasons other than the tax reasons for believing that the loss should be delayed, it should——

The Court: That is true as an abstract proposition of law, but we are attempting to explain this to a jury.

"Such as for the primary purpose of gaining——" Wouldn't you say that would explain it? "Such as primarily for the purpose of gain——" That might read better, mightn't it?

Mr. Miller: Yes, sir.

The Court: If the jury thinks that he did this primarily for the purpose of gaining a tax benefit they aren't going to think that it was—they are certainly likely to think that it was for reasons other than business care and prudence.

Mr. Miller: That is correct.

The Court: In view of 11(d) may we not omit entirely the second paragraph of 11(b)?

Mr. Miller: I would say so, Your Honor.

The Court: Isn't it repetitious?

Mr. Miller: Yes, Your Honor, I suppose so. I would be agreeable to that, Your Honor.

There is one other instruction——

The Court: Just a moment. One thing at a time, gentlemen.

Mr. McHale: I think, Your Honor, that 11(b) expresses a little something in addition to 11(d). As Your Honor will remember, that, as originally drafted in my instruction, it was a tenuous claim for reimbursement, and I think that in the second paragraph in 11(b) there is the sense of the unreasonableness of pursuing the claim for that purpose. I grant that there is some duplication of purpose,

but I think that it might be a little clearer if both were in.

Mr. Miller: The point is, Your Honor, it seems to me, that there is a long and undue—I won't say undue, but perhaps unbalanced—dwelling upon the question of whether it was a tax reason——

The Court: I assume you gentlemen will argue the matter. Of course, there is a difference in the two points. The first is general, introducing the thought that the taxpayer may not unreasonably——

Mr. Miller: Well, I don't really care, Your Honor, about that. I would be agreeable to leaving it in or taking it out. The more important question to me is another instruction we requested that was omitted. I really don't care much about this aspect of the instruction.

The Court: I will combine the first two paragraphs of 11(b)—that is, the first two paragraphs of present 11(d).

Mr. Miller: Is that 11(d) you are combining.

The Court: And make them both into 11(b)—new 11(b).

Now, the last paragraph of old 11(b) will become new 11(d).

What was your other one now, Mr. Miller?

Mr. Miller: Your Honor, it is the instruction that plaintiff requested as A-5. It is taken from Your Honor's opinion.

The Court: There are a great many things in that opinion that can't help the jury, in my view. What is it about? A-5?

Mr. Miller: Yes, sir. "It is the policy of the law to claim deductions——"

The Court: No, no. I don't feel that should be given. When you tell them that they ought not to penalize the taxpayer, you are directing a verdict for the plaintiff, aren't you?

Mr. Miller: Well, Your Honor, we don't want any undue advantage.

The Court: I don't see how you can give that instruction without giving an undue advantage.

In these that the Court has proposed, do you have any further suggestions?

Mr. Miller: No, Your Honor, we do not.

The Court: In 12, as now written, I have at line 10, "Then the jury should find that the loss for income tax purposes was——" And then I inserted before "properly", or I intend to insert, "was not finally and entirely sustained, and so did not become properly deductible until the year of settlement—the year 1948."

I think it will tie it in better to tie this standard better with the first interrogatory, the language of the first interrogatory. And then again down at line —this will be rewritten and given to you—down at line 17, "Then the jury should find with respect to the Government's contention——"

By the way, is there any objection to using that form, "the Government's contention"?

Mr. McHale: No, Your Honor. I think it is proper here.

The Court: Very well. "Then the jury should find that the loss from income taxes was—" insert

"finally and entirely sustained and so was properly deductible in the year of physical destruction of the property—the year 1938 only."

Is there anything else in that group?

Mr. McHale: Your Honor, I think I made clear to Your Honor that I am going to make formal exceptions, although I realize Your Honor has set the law of the case, so I am not raising them.

The Court: I just meant—I have already indicated what I intend to give. I just want your suggestions as to whether I should.

Mr. McHale: There were a couple of instructions that I had suggested with respect to burden of proof.

The Court: Well, isn't that covered in the general —I didn't want to cover specially the burden of setting aside commissioner's findings. That would only confuse them, I think. The plaintiff here has the burden, clearly, by a preponderance, and, of course, you may argue that, that the plaintiff has that burden.

Mr. McHale: Very well.

The Court: Here's an instruction 13.

Mr. Clerk, will you hand a copy to counsel.

Mr. Miller: Your Honor, only one question.

The Court: You are referring to instruction 13?

Mr. Miller: Yes, Your Honor. At the end of the instruction, "If plaintiff Earl Callan regularly carried on at and prior to—" this says the loss—could we say "the flood in 1938"?—characterization of it as a loss in 1938 seems to me might be misconstrued, since the question is whether we have a deductible

loss in 1938 or 1948. And the word "flood" would say the same thing.

The Court: Yes. Any objection?

Mr. McHale: No objection to that, Your Honor. I was wondering about my proposed instructions with respect to that second issue.

The Court: It seems to me, Mr. McHale, that we don't have a question of abandonment. You can argue that question of abandonment if you want to. I don't see where there is any contention he changed the situation any time he was occupying that house.

Mr. McHale: I think the principle of income tax law in this country is, and always has been, that where a person resides is his residence and is not available for business purposes. I know the English law takes a different position.

The Court: There is nothing to prevent this man from moving into the place for the purpose of renting it and staying there while he is renting.

Mr. McHale: But while he is there I don't believe that it is available as business property.

The Court: I had the impression that the instructions that you request on this question of abandonment were correct, as a matter of law, but weren't applicable.

Now, if it is the rule in tax cases, as you contend, that no matter what the intent of the family is, if the head of the family says, "We will move in there just till we rent it and rent it as rapidly as we can and when we rent it we will more—" if it is your contention that the law immediately says that it is his residence the moment he moves in there and

spends the night, then it seems to me that the Court would have to direct a verdict.

Mr. McHale: I move for a directed verdict on that ground, Your Honor. And if you want me to brief it——

The Court: I had the impression it was a question of intent, that that man might move into a place for the purpose of occupying it the better to rent it.

In the early days of the automobile business, as I recall it, the dealer used to buy him a demonstrator and drive it around until he found a buyer and he would sell it. Then he would send for another one. And I suppose that plaintiff's contention is here, as I understand it, that he lived in these houses to demonstrate, to show them,——

Mr. Miller: That is correct.

The Court: ——the better to be on hand to show them.

Mr. McHale: I understand his contention very well.

The Court: Don't you think that instruction 13 as now written fairly states the respective contentions on that issue?

Mr. McHale: Yes. But what I wanted——

The Court: If you want to press that other point, I will be glad to look at any cases you bring in tomorrow morning. But unless they are binding precedent, I would not think that very good law.

Mr. McHale: I think the history of the income tax in this country is that the personal residence is just not available for business purposes, either for

losses, expenses,—whereas the English experience, their income tax law has been to the contrary.

Mr. Miller: Your Honor, I would like to interject at this point because we have briefed cases—we have set forth cases in our authorities which clearly set forth the negation of Mr. McHale's contention. I have been through this with Mr. McHale before, and the basis of his contention is that the—by occupying a residence, per se, regardless of any facts, it automatically becomes dedicated to personal use.

Now, we have submitted in support of our instructions a great number of cases where the plaintiff did occupy the property and it was held, nevertheless, that when he sold at a loss he was allowed to deduct the loss because it was a transaction for profit. Now, those decisions held that it was not a personal use, even though the party was in there. They had to so hold in order to find it was loss and a transaction entered into in profit. And everyone of Mr. McHale's cases that he mentioned as authorities for his requested instructions involving cases where it stated, as a fact, that the owner of the property moved into the property, lived there as his personal residence for a long period of years, and then he eventually made some effort to abandon it—which is not our case. And we don't make any claim of intention ever changing; just the same intention at all times.

The Court: I will be glad to see whatever you wish to submit on that, Mr. McHale.

Mr. McHale: Very well.

The Court: Here are copies of revised instruction 11(d) for each of you gentlemen.

Suppose you gentlemen go over these this evening and if you wish to take up any matter without the jury tomorrow morning, let the clerk know and we will convene without the jury and take up any matters you wish.

* * * * *

The Court: Now, will you gentlemen go over these again this evening, and if you see any further matters you wish to suggest, please do so. Let the clerk know and we will convene without the jury.

As I understand it, the form of special verdict is agreeable to both of you.

Mr. McHale: That is correct, Your Honor.

Mr. Miller: That is correct, Your Honor.

The Court: Very well.

Mr. Miller: Is there going to be a new 11(d), Your Honor?

The Court: A new 11(d)?

Mr. McHale: A new 11(d) is the last paragraph of old 11(b).

Mr. Miller: We have 11(b), the new 11(b), and take the old 11(b) and mark it 11(d) and mark——

The Court: No. There will be one brought out just shortly.

Mr. Miller: There is one more to come?

The Court: Yes, the old 11(d) should be destroyed. I haven't destroyed mine either, I find.

The old 11(d) should be removed. There will be a new 11(d). You have that in mind, don't you?

Mr. Miller: Yes, sir.

The Court: Would you see, Mr. Bailiff, before we adjourn, if my secretary has any others written?

Here is your instruction (d) gentlemen, 11(d).

Revised instruction 12 will be ready in a very few moments.

We will adjourn at this time, and if you want to wait a few moments, I will send the copies out.

The trial will be recessed until tomorrow morning at 9:30.

(Whereupon the trial was adjourned until 9:30 a.m., February 10, 1955.)

The Court: Are there ex parte matters?

The Clerk: No, Your Honor.

The Court: The case on trial, is it stipulated, gentlemen, the jury are absent?

Mr. McHale: So stipulated, Your Honor.

Mr. Miller: So stipulated, Your Honor.

The Court: Do you have some matters you wish to take up in the absence of the jury?

Mr. McHale: That is correct, Your Honor. I have done some further work on this second issue since last night. I have three proposed issues—the third one my secretary is bringing down—two of which I have handed the clerk and served copies on counsel.

I have cited there what I think is the leading case on the subject and the particular quotation which occurs again, the Circuit Court opinion with respect to appropriating to business use—and that is instruction No. 18——

The Court: Well, let's take up first—the plaintiff

has requested instruction D which involves the first issue, doesn't it?

Mr. Miller: Yes, it does, Your Honor; all my requested instructions.

The Court: I don't know what this requested instruction D means.

Mr. Miller: Sir, plaintiff's requested instruction D is requested in addition to the Court's proposed charge 11(d).

The Court: Let's take that up first.

Have you looked at them, Mr. McHale?

Mr. McHale: I just received them. Which one are we discussing?

Mr. Miller: Plaintiff's C, which is proposed as an addition to the Court's 11(d).

Now, Your Honor, let me make it plain, first, that in my opinion the last two paragraphs of 11(b) here, I think, should not be in the instructions because I think they are covered already by the part of 11(a) which tells the jury to consider whether plaintiff Earl Callan believes reasonably and in good faith he had a reasonable chance of recovery on his claim.

The Court: I don't understand what you are saying now.

Mr. Miller: Well, Your Honor, what I am saying——

The Court: You say that 11(b) as presently constituted—are you referring to that?

Mr. Miller: Yes, sir, that is correct.

The Court: ——that the last two paragraphs are repetitious? Is that what you are saying?

Mr. Miller: That is right. However, if Your Honor feels otherwise, then in order to make 11(b) a fair instruction——

The Court: Repetitious of what? Let's be specific about it.

Mr. Miller: Repetitious of whether plaintiff Earl Callan believed reasonably and in good faith that he had a reasonable chance of recovery on his claim against the Flood Control District, which is part of 11(a), subparagraph (4) at the end.

The Court: Well, I am inclined to agree with you; and all the more so since it will make the instruction more brief than otherwise. I am inclined to eliminate the last two paragraphs of present instruction 11(b).

Mr. McHale: Your Honor, I object to that; I don't think it is adequately covered elsewhere.

The Court: Of course, you could tell the jury all the myriad circumstances, but it seems to me this is a matter of argument.

Mr. Miller: In which case requested instruction C becomes superfluous, and we withdraw the request of that instruction.

The Court: That will be done. That is a matter you can argue, Mr. McHale. It seems to me that it is analogous in a negligence case to singling out some of the surrounding circumstances and to tell the jury they are to consider them. You can't mention all of them. We do mention some of the salient ones in 11(a).

Mr. McHale: But, Your Honor, there is no—I think that the——

The Court: The jury are told they are to consider all the surrounding circumstances, aren't they? Now, we can't manifestly detail all of them, can we?

Mr. McHale: You are detailing them in 11, and I think the last two paragraphs should be added to 11(a), the additional circumstances. If you are going to detail some of them, the others, favorable to the Government, shouldn't be left out.

The Court: Are the ones that are included favorable to the plaintiff?

Mr. McHale: I think there are some instructions, 2 and 3, that are favorable to the plaintiff—and 4. I mean, good faith. Your Honor knows our position with respect to this.

Mr. Miller: Your Honor, figure 1 is certainly not favorable. and the first——

The Court: 2 and 3 are favorable and 1 and 4 are not, are they?

Mr. McHale: I mean, if you are going to say just the belief of the plaintiff, the plaintiff can always believe in good faith. But I think the tax effect of this thing is also a factor that should be considered.

The Court: Mr. McHale, you are saying, in the portion in question, you are attacking the plaintiff's good faith, aren't you? Now, you may make any number of arguments attacking his good faith. And this is just pointing out one of them. It seems to me it is just another way of saying specifically that you may consider it as good faith or bad faith, and here are some things that might enable you to find that he acted in bad faith.

Mr. McHale: But I think the fact that the tax-

payer can't choose the year of loss is a matter that the jury should be instructed on. It is a matter that——

The Court: Well, that's left in instruction 11(b). the first two paragraphs of 11(b) remain.

Mr. McHale: But the last paragraph is, "The jury may determine whether, as the Government here contends, Earl Callan delayed deduction of the loss in question to a year later than 1938 for reasons other than business care and prudence, such as primarily for the purpose of gaining a tax benefit which otherwise would have been useless to him since a taxpayer is not allowed to pick and choose the year of loss."

The Court: But subparagraph 2, the second subparagraph of 11(b) remains. It reads, "A taxpayer may not reasonably defer—" if we say "postpone", I think the jury will know more what *the* means.

"——postpone the deduction for a loss until some more tax-advantageous year—" "—until some later and possibly more tax-advantageous year, by pursuing unreasonably a claim for possible reimbursement for a loss."

Mr. McHale: Can we add there, since a taxpayer is not allowed to pick and choose the year of his loss for the sole purpose of gaining the most advantageous benefit?

The Court: Yes, that may be done.

That will be done. Of course, as I understand it, in the best of faith the taxpayer may not unreasonably pursue a claim for possible reimbursement and

postpone his deduction until some later year, even though the later year is a less tax-advantageous year. Is that not so?

Mr. Miller: That is correct, Your Honor.

Mr. McHale: That is right. I mean, can't do it for tax damages.

The Court: Can't do it either aimlessly or for that purpose, can he?

Mr. McHale: I think it should be highlighted here that this the fact, because I think the "best of faith" is not going to be too clear to the jury.

The Court: Well now, instruction 11(b) will be rewritten to read as follows: "The mere existence of a claim or suit for recovery against the Los Angeles Flood Control District is not enough in and of itself to prevent the loss from being deductible in 1938. A taxpayer may not reasonably postpone the deduction for loss until some later and possibly more tax-advantageous year by pursuing unreasonably a claim for possible reimbursement for his loss, since a taxpayer is not allowed to pick and choose the year of loss for the sole purpose of gaining the most advantageous tax benefit."

Does that cover it, gentlemen?

Mr. Miller: Yes, Your Honor.

Mr. McHale: Yes, Your Honor.

The Court: Very well. That will be revised instruction 11(b).

Then the plaintiff withdraws requested instruction C?

Mr. Miller: That is correct, Your Honor.

* * * * *

Anything further, gentlemen?

Mr. Miller: Not from the plaintiff, Your Honor.

Mr. McHale: That is all, Your Honor.

The Court: Is it stipulated, gentlemen, that the jury are present?

Mr. Miller: So stipulated, your Honor.

Mr. McHale: So stipulated.

The Court: Members of the jury, you have heard the evidence and the argument. Now it is the duty of the court to instruct you as to the law governing the case. It is your duty, as jurors, to follow the law as stated in the instructions of the court and to apply the law so given to the facts as you find them from the evidence before you. You are not to single out one instruction alone as stating the law, but must consider the instructions as a whole.

Regardless of any opinion you may have as to what the law ought to be, it would be a violation of your sworn duty to base a verdict upon any other view of the law than that given in the instructions of the court.

You have been chosen and sworn as jurors in this case to try the issues of fact presented by the allegations of the complaint of the plaintiffs Earl Callan and Helen W. Callan and the answer of the defendant. You are to perform this duty without bias or prejudice as to any party. The law does not permit jurors to be governed by sympathy, prejudice, or public opinion. The parties and the public expect that you will carefully and impartially consider all the evidence, follow the law as stated by

the court, and reach a just verdict, regardless of the consequences.

As you have heard counsel for the defendant say, though this in name is a suit against the Collector of Internal Revenue it, in substance, is a suit against the Government.

This case should be considered and decided by you as an action between persons of equal standing in the community, of equal worth, and holding the same or similar stations in life. The Government is entitled to the same fair trial at your hands as a private individual. The law is no respector of persons; all persons, including the Government, stand equal before the law, and are to be dealt with as equals in a court of justice.

The burden is on the plaintiff in a civil action, such as this, to prove every essential element of plaintiffs' case by a preponderance of the evidence. If the proof fails to establish any essential element of plaintiffs' case by a preponderance of the evidence, then you must find for the defendant.

The term "preponderance of the evidence" means the greater weight of the evidence. In other words, such evidence as, when weighed with that opposed to it, has more convincing force and produces in your minds conviction of the greater probability of truth, after you have considered all the evidence in the case.

Evidence may be either direct or indirect. Direct evidence is that which in itself, if true, conclusively establishes a fact. Indirect evidence is that which tends to establish a fact in dispute by proving

another fact. Indirect evidence is of two kinds, namely, presumptions and inferences.

An inference is a deduction or conclusion which reason and common sense lead the jury to draw from facts which have been proved.

A presumption is an inference which the law requires the jury to make from particular facts. Unless declared by law to be conclusive, a presumption may be overcome or outweighed by direct or indirect evidence to the contrary of the fact presumed; but unless so outweighed, the jury are bound to find in accordance with the presumption.

Unless and until outweighed by evidence to the contrary, the law presumes that private transactions have been fair and regular; that the ordinary course of business has been followed; and that the law has been obeyed.

Statements and arguments of counsel are not evidence in the case, unless made as an admission or stipulation of fact. When the attorneys on both sides stipulate or agree as to the existence of a fact, the jury must accept the stipulation as evidence and regard that fact as conclusively proved.

The evidence in the case consists of the sworn testimony of the witnesses, all exhibits which have been received in evidence, all facts which have been admitted or stipulated, and all applicable presumptions stated in these instructions. Any evidence as to which an objection was sustained by the court, and any evidence ordered stricken by the court, must be entirely disregarded.

You are to consider only the evidence in the case.

But in your consideration of the evidence you are not limited to the bald statements of the witnesses. On the contrary, you are permitted to draw, from facts which you find have been proved, such reasonable inferences as seem justified in the light of your experience.

You, as jurors, are the sole judges of the credibility of the witnesses and the weight their testimony deserves. A witness is presumed to speak the truth. But this presumption may be outweighed by the manner in which the witness testifies, by the character of the testimony given, or by contradictory evidence. You should carefully scrutinize the testimony given, the circumstances under which each witness has testified, and every matter in evidence which tends to indicate whether the witness is worthy of belief. Consider each witness's intelligence, motive and state of mind, and demeanor and manner while on the stand. Consider also any relation each witness may bear to either side of the case; the manner in which each witness might be affected by the verdict; and the extent to which, if at all, each witness is either supported or contradicted by other evidence.

Inconsistencies or discrepancies in the testimony of a witness, or between the testimony of different witnesses, may or may not cause the jury to discredit such testimony. Two or more persons witnessing an incident or a transaction may see or hear it differently; and innocent misrecollection, like failure of recollection, is not an uncommon experience. In weighing the effect of a discrepancy, consider

whether it pertains to a matter of importance or an unimportant detail, and whether the discrepancy results from innocent error or willful falsehood. If you find the presumption of truthfulness to be outweighed as to any witness, you will give the testimony of that witness such credibility, if any, as you may think it deserves.

A witness may be discredited or impeached by contradictory evidence; or by evidence that at other times the witness has made statements which are inconsistent with the witness's present testimony.

If you believe any witness has been impeached and thus discredited, it is your exclusive province to give the testimony of that witness such credibility, if any, as you may think it deserves.

If a witness is shown knowingly to have testified falsely concerning any material matter, you have a right to distrust such witness's testimony in other particulars; and you may reject all the testimony of that witness or give it such credibility as you may think it deserves.

While the burden rests upon the party who asserts the affirmative of an issue to prove his allegation by a preponderance of the evidence, this rule does not require demonstration, or such degree of proof as produces absolute certainty; because such proof is rarely possible.

In a civil action such as this, it is proper to find that a party has succeeded in carrying the burden of proof on an issue of fact if, after considering all the evidence in the case, the evidence favoring such party's side of the question is more convincing than

that tending to support the contrary side, and if it causes the jurors to believe that the probability of truth on such issue favors that party.

You are not bound to decide any issue of fact in accordance with the testimony of any number of witnesses which does not produce conviction in your minds, as against the testimony of a lesser number of witnesses or other evidence which does produce conviction in your minds.

The test is not which side brings the greater number of witnesses, or presents the greater quantity of evidence, but which witness and which evidence appeals to your minds as being most accurate and otherwise trustworthy.

The testimony of a single witness, which produces conviction in your minds, is sufficient for the proof of any fact, and would justify a verdict in accordance with such testimony even though a number of witnesses may have testified to the contrary if, after weighing all the evidence in the case, you believe that the balance of probability points to the accuracy and honesty of the one witness.

The parties agree that the actual physical loss occurred in March of 1938. It is also agreed that plaintiff Earl Callan's claim for reimbursement against the Los Angeles County Flood Control District for damages due to claimed negligence by the District had been denied by the Flood Control District at the close of 1938. The law permitted plaintiff Earl Callan nonetheless to delay claiming a tax deduction for the loss while pursuing his claim against the Flood Control District, if to do so would

be the exercise of ordinary business care and prudence under all the surrounding circumstances.

The Government contends that the loss should have been deducted in the year 1938 and that the postponement of the claimed deduction until the claim against the Flood Control District was finally settled was not an act done in the exercise of ordinary business care and prudence under all the surrounding circumstances, because, the Government argues, the possibility of recovery on the claim against the Flood Control District was too contingent and uncertain.

Plaintiffs contend that in the light of all the surrounding circumstances plaintiff Earl Callan exercised ordinary business care and prudence in delaying deduction of the loss until 1948.

This is the first issue the jury are called upon to determine.

In determining whether plaintiff Earl Callan exercised ordinary business care and prudence in delaying deduction of the loss for income tax purposes until his claim against the Los Angeles County Flood Control District was finally settled in 1948, the jury should consider all the surrounding circumstances as shown by the evidence.

In this connection the jury should consider, along with other surrounding circumstances shown by the evidence: (1) the date of the physical loss; (2) whether plaintiff Earl Callan made a full and fair disclosure of the facts to an attorney and thereafter reasonably and in good faith followed and relied upon the advice of his counsel; the jury may also

consider the success or lack of success of plaintiff Earl Callan in the prosecution of his claim against the Flood Control District; (3) whether plaintiff Earl Callan prosecuted his claim against the Flood Control District in good faith that he had a reasonable chance of recovering on his claim against the Flood Control District.

The mere existence of a claim or suit for recovery against the Los Angeles County Flood Control District is not enough in and of itself to prevent the loss from being deductible in 1938.

A taxpayer may not reasonably postpone the deduction for loss until some later and possibly more tax advantageous year by pursuing unreasonably a claim for possible reimbursement for his loss, since a taxpayer is not allowed to pick and choose the year of loss for the sole purpose of gaining the most advantageous tax benefit.

If you find that plaintiff Earl Callan claimed on his 1938 income tax return any loss arising from damage to any part of his property by reason of the 1938 flood, that fact, even though no claim as to that deduction is involved in this case, may be considered in determining plaintiff Earl Callan's good faith in postponing any deduction for the loss arising from flood damage to the properties involved in this case, until after his claim against the Flood Control District had been settled, in 1948.

The stipulated or agreed fact that no deduction was claimed for the loss here in question on plaintiff Earl Callan's 1938 tax return may be considered in determining the issue as to whether or not he in

good faith postponed claiming a tax deduction for the loss.

If the jury should find from the evidence, as plaintiffs contend, that plaintiff Earl Callan did exercise ordinary business care and prudence in delaying deduction of the loss in question for income tax purposes until his claim against the Los Angeles County Flood Control District was finally settled in 1948, then the jury should find that the loss for income tax purposes was not finally and entirely sustained, and so did not become properly deductible, until the year of settlement—the year 1948.

If on the other hand the jury should find from the evidence, as the Government contends, that plaintiff Earl Callan's postponement of deduction for the loss was not an act done in the exercise of ordinary business care and prudence, then the jury should find that the loss for income tax purposes was finally and entirely sustained, and so was properly deductible, in the year of physical destruction of the property—the year 1938, only.

Turning now to the second issue in the case, it is the contention of plaintiffs in this action that plaintiff Earl Callan originally acquired the real estate, constructed the improvements thereon, and acquired the furniture and furnishings, for the purpose of making a profit in the course of plaintiff Earl Callan's business of constructing, furnishing, owning, operating and renting residential real estate, and that all said property was held by plaintiff Earl Callan at all times to and including the time of the flood in 1938 in the course of that business.

It is plaintiffs' contention that the reason, purpose and character of plaintiff Earl Callan's occupancy of the premises at 1740 Riverside Drive, including the use of the improvements, furniture and furnishings was at all times during such occupancy and use, to complete the proper furnishing thereof and more advantageously to display such property to prospective tenants or purchasers in the course of such business and that, because such real estate, improvements, furniture and furnishings were business property of plaintiff Earl Callan, plaintiffs' loss, resulting from the damage and destruction of such property, is attributable to the operation of a business which plaintiff Earl Callan regularly carried on—namely, the business of constructing, furnishing, owning, operating and renting residential real estate.

It is the contention of the Government, as defendant in this action, that a major reason, purpose and character of plaintiff Earl Callan's occupancy of the premises at 1740 Riverside Drive, including the use of the improvements, furniture and furnishings, was not business but that of a personal residence for plaintiff Earl Callan, and that because such real estate, improvements, furniture and furnishings were not business property, plaintiffs' loss resulting from the damage and destruction of such property is not attributable to the operation of a business regularly carried on by plaintiff Earl Callan.

So the second issue for the jury to decide is whether or not plaintiffs' loss, resulting from the dam-

age and destruction of the property at 1740 Riverside Drive, including the real estate, improvements, furniture and furnishings, is attributable to the operation of a business which plaintiff Earl Callan regularly carried on at and prior to the flood in 1938.

If you find from the evidence that plaintiffs occupied the property for any other reason than that of furthering the interests of plaintiff Earl Callan's business, then you should find that the occupancy was not for business purposes, and that the loss was not attributable to the operation of a business.

In order that you might better understand this issue, or the purpose of it, perhaps I should add, as I understand it, you see, you have two years here, 1938 and 1948, and if you find that the plaintiff exercised reasonable care, business care and prudence in postponing the loss until 1948, he is entitled to deduct it whether this is a residential property or a business property. As I understand it, the issue as to whether or not it is a residence or business arises because of the plaintiffs' desire to carry back the deduction from 1948 to 1946, and that can be done only if it is a business loss, as I understand it.

Is that correct?

Mr. McHale: That is correct, your Honor.

Mr. Miller: Yes, your Honor.

The Court: You agree on that, Mr. Miller?

Mr. Miller: Yes, sir, that is correct.

The Court: So that is the way that second issue arises in the case.

A business is that which occupies the time, atten-

tion and labor of men for the purpose of a livelihood or profit.

A person can be engaged in more than one trade or business.

The renting of real property is a business, and rental properties are considered as used in that business.

If property is purchased with the intention of improving it and operating it in the purchaser's business, such property is not deprived of its character as used in the trade or business by the occurrence of unexpected events which prevent actual operation of such property in such business.

If the property is owned by a taxpayer as business property, a loss resulting as a consequence of destruction or damage or such business property by a flood is a loss attributable to the operation of the business.

The law of the United States permits the judge to comment to the jury on the evidence in the case. Such comments are only expressions of the judge's opinion as to the facts; and the jury may disregard them entirely, since the jurors are the sole judges of the facts.

During the course of a trial, I occasionally ask questions of a witness, in order to bring out facts not then fully covered in the testimony. Do not assume that I hold any opinion on the matters to which my questions related. Remember at all times that you, as jurors, are a liberty to disregard all comments of the court in arriving at your own findings as to the facts.

The verdict must represent the considered judgment of each juror. In order to return a verdict, it is necessary that each juror agree thereto. Your verdict must be unanimous.

It is your duty, as jurors, to consult with one another and to deliberate with a view to reaching an agreement, if you can do so without violence to individual judgment. Each of you must decide the case for yourself, but do so only after an impartial consideration of the evidence with your fellow jurors.

In the course of your deliberations, do not hesitate to re-examine your own views and change your opinion if convinced it is erroneous. But do not surrender your honest conviction as to the weight or effect of evidence solely because of the opinion of your fellow jurors, or for the mere purpose of returning a verdict.

You are not partisans. You are judges—judges of the facts. Your sole interest is to ascertain the truth from the evidence in the case.

Before giving you the final instruction and explaining to you the form of verdict, we will take a brief recess of three minutes. You will be excused with the usual admonition because the case has not yet been submitted to you for your verdict.

You will now be excused for a three-minute recess.

(Whereupon the jury retired from the courtroom.)

The Court: Very well, gentlemen. Are you ready to have the jury summoned? If there are any further objections before the jury finally retires, if

either counsel think of anything further they wish to make a record of, if you will just indicate that you wish to take up some matter before the jury retires, the jury will be again excused.

Mr. Miller: Thank you, your Honor.

Mr. McHale: Thank you, your Honor.

The Court: Please summon the jury.

(Whereupon the jury returned to the courtroom.)

The Court: Is it stipulated, gentlemen, the jury are present?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated, your Honor.

The Court: Upon retiring to the jury room, you will select one of your number to act a foreman. The foreman will preside over your deliberations and will be your spokesman in court. A form of special verdict has been prepared for your convenience, and attorneys on both sides have agreed that it is in proper form to submit, and I exhibit it to you now. It is a two-page document, rather formidable looking, but it isn't as bad as it looks. It is entitled in the court and cause and sets forth some questions.

It reads: "Special Verdict.

"We, the jury in the above-entitled cause, unanimously find the answer to Question No. 1, to wit:

Question 1: 'Was plaintiff Earl Callan's loss from the March 2, 1938 flood finally and entirely sustained and deductible by him in 1938 or 1948?'

Answers: (1938).... (1948)....."

So, you are called upon to find, under the instructions, whether plaintiff Earl Callan acted with rea-

sonable business care and prudence in postponing claiming the deduction from 1938 when the physical loss occurred until 1948 until after he settled his claim finally with the Flood Control District. So you are called upon to answer that question; either 1938, and the foreman will write in the blank the appropriate date, either in 1938 or 1948.

Now, if your answer to that question is "1938," then Question 2 doesn't arise, whether or not it is business property or residence property doesn't arise. The directions are right here on the face of the special verdict. It says in parentheses, "(If the first question is answered '1938' Question No. 2 need not be answered.)"

Now, Question No. 2:

"We, the jury in the above-entitled cause, unanimously find the answer to Question No. 2, to wit:

Question 2: 'Was any portion of Earl Callan's loss attributable to the operation of a business regularly carried on by him on March 2, 1938, at 1740 Riverside Drive with respect to the following property there located:

(a) 'To the Land?'

Answers: (No).... (Yes)....

(b) 'To the buildings and improvements?'

Answers: (No).... (Yes)....

(c) 'To the furniture and furnishings?'

Answers: (No).... (Yes)....."

As you will notice, that property has been broken down and instead of being treated as one piece of property at 1740 Riverside Drive it has been broken down really into three pieces of property; namely,

the land and building and improvements, and the furniture and furnishings. So it is the same question that is asked you as to all three of those items. Those three questions (a), (b) and (c) comprise No. 2.

And then, "Dated: This....day of February, 1955.

.....

Foreman of the Jury"

You will take this form of special verdict with you to the jury room and after you have reached your unanimous answer, as required by the instructions, the foreman will fill in the necessary blanks and date and sign the special verdict and return with it to the courtroom.

Mr. Clerk, will you swear the bailiffs.

(Whereupon, the bailiffs were sworn by the clerk.)

The Court: Now, ladies and gentlemen of the jury, you will be in the custody of the bailiffs who have just been sworn. All of the exhibits which have been received in evidence in the case will be sent to the jury room.

Do you have all the exhibits ready, Mr. Clerk?

The Clerk: I do, your Honor.

The Court: Have counsel checked them? Are you satisfied, gentlemen? First, are there any exhibits that were marked for identification only and not offered?

The Clerk: There was one exhibit, your Honor.

The Court: That was Exhibit 16.

The Clerk: Exhibit 16.

The Court: Are you agreed on that?

Mr. McHale: Yes, that is not to go in.

Mr. Miller: That is correct.

The Court: May it be stipulated that the clerk has handed to the bailiff all the exhibits which were received in evidence in the case, and such exhibits may be taken to the jury room?

Mr. Miller: The stipulation of facts, is that included?

The Clerk: That is included.

The Court: That is Exhibit 33.

The stipulation of facts, ladies and gentlemen, which is the agreement the parties made as to the facts and which the Government says was substituted for any evidence the Government wishes to offer on defense is Exhibit 33. It is a written document that looks something like the special verdict, only it contains a great many more pages.

And the instructions of the court will be sent to the jury room.

I suppose, this being 12:00 o'clock, the first order of business will be for you to go to lunch. So the clerk will be instructed to enter an order at this time directing the bailiff to take you to lunch, whenever you are ready to go, at the expense of the parties.

You may now retire to the jury room to deliberate upon your verdict.

Mr. McHale: Your Honor,——

The Court: Just a moment, please.

Mr. McHale, do you wish something before the jury retires?

Mr. McHale: Yes, your Honor.

The Court: The jury will resume its place in the

box. I wish you would have been quicker about that, Mr. McHale.

Mr. McHale: I am sorry, your Honor.

The Court: Is it stipulated the jury are all present?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated, your Honor.

Mr. McHale: Before the jury retires, I would like to address a remark to the court, in the absence of the jury.

The Court: Is it essential, Mr. McHale?

Mr. McHale: Could I approach the bench?

The Court: Yes, you may.

(Whereupon the following proceedings were had outside the hearing of the jury.)

The Court: Is it stipulated, gentlemen, these proceedings are being taken at the bench outside the hearing of the jury?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated, your Honor.

Mr. McHale: With respect to the instructions to the jury, your Honor's informal remarks, I wish the standard to apply; I wish my exception to run——

The Court: They will apply. I think your position is perfectly clear.

(Whereupon the following proceedings were had in the presence and hearing of the jury.)

The Court: Very well, ladies and gentlemen of the jury, you may retire to the jury room to deliberate upon your verdict.

[Endorsed]: Filed July 1, 1955.

Wednesday, February 9, 1955; 2:45 p.m.

The Court: Is it stipulated, gentlemen, the jury have left the courtroom?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated, your Honor.

The Court: You may make your motion, I take it, for judgment of dismissal under the rule.

Mr. McHale: Yes, your Honor; motion for directed verdict.

The Court: Motion for judgment of dismissal.

Mr. McHale: Motion for judgment of dismissal. First of all I would like to——

The Court: I take it it is made on the ground that upon the facts and the law the plaintiffs have shown no right to relief.

Mr. McHale: That is right, your Honor. And the first ground would be that made in our previous motions to dismiss, which has been thoroughly briefed and your Honor has ruled.

Secondly, I believe that under the facts as adduced today and yesterday in the trial of this case that the loss is final and complete. And the facts further show that the plaintiff himself regarded it as such in that with respect to 1705 and 1717 Rancho he deducted that loss on his 1938 income tax return by taking as an expense item the cost of repairs to those two houses, which in effect was taking a loss. And the income tax law is that you can't take a loss twice. You can either take it as a loss or you can deduct it. But what he did here was in 1938 he took the cost of repairs which in effect was taking the loss

in 1938 as to two of the four parcels of real estate.

The Court: He took that as an expense.

Mr. McHale: He took it as an expense, but——

The Court: It wouldn't be a capital loss, would it?

Mr. McHale: Nevertheless, your Honor, that flowed from the flood damage in 1938.

The Court: Yes. Is there anything inconsistent in taking that deduction and not claiming the other as a closed transaction?

Mr. McHale: I think so. He had the same claim for reimbursement for those repairs to those two houses against the Los Angeles Flood Control District as he did to 1740 Riverside Drive and 1723 Rancho; and by deducting that from his income rentals in 1938 he in effect took that loss in 1938. And that's the second ground of the Government's motion.

The third ground is with respect to the proposed second issue in this case, the special verdict. And that is this: That plaintiff lived in the 1740 Riverside Drive property up to the time of the flood; had not rented or leased it to anyone else; had not acquired other quarters or had done nothing to show an intention to acquire other quarters. Therefore, one, he had no intention to abandon it as a residence, because it was his residence. And secondly, he had not in fact abandoned it. Both factors are necessary under the Internal Revenue laws before the loss of that residence can arise from the operation of a business. And for that reason we request a directed verdict on issue No. 2.

As a third ground, and that is as to the second ground of the special verdict, that in effect in asking

for a net operating loss carry-back from 1944 to 1946, the plaintiff is asking for provisions that were in the Internal Revenue law in 1948; carry-back net operating loss. However, the basic factual situation, from which this arose and which was postponed because of the chance of reimbursement, arose in 1938. At that time the provisions for net operating losses were not in the Internal Revenue laws, were not enacted until later; and when they were enacted were made specifically inapplicable to a period prior to January 1939. And for that second reason with respect to the special verdict we move for a judgment on the second issue.

The Court: You mean inapplicable to any transactions occurring prior to 1939?

Mr. McHale: Well, yes, it was, your Honor. In other words, when they enacted the law it was for periods after 1939. Now, this arises out of a transaction of 1938, so I say it was the spirit of the law that this should not apply to a transaction arising in 1938.

The Court: Well, isn't our problem here on the second issue whether or not the jury might reasonably find from the evidence that the plaintiff, Earl Callan, occupied the property primarily for the purpose of renting or selling it rather than primarily as a residence?

Mr. McHale: That is right, that he occupied it. And it follows from that, under the provisions of the law, that it was an operating expense rather than a personal expense or personal casualty loss; that it would go as an operating loss. It would be carried

back to the 1948 law. And I want to point out to the court that under the laws existing in 1938, when the flood occurred, this could not be done. And when the net operating provisions of law were enacted they were made inapplicable to the period before that.

The Court: But if this loss is a business loss and is properly deductible in 1948, then it would properly be carried back to 1946.

Mr. McHale: The point I am making is, not if it relates to 1938.

The Court: You say the spirit of the law——

Mr. McHale: Yes. As I understand your Honor's decision, the loss actually occurs in 1938 but it is postponed because of the chance of reimbursement; and the spirit of the law was not to allow the net operating loss provisions prior to 1939.

The Court: No. The loss, I suppose philosophically, doesn't occur in 1938; it does physically but not for tax purposes if the deduction is postponed, because by definition the loss must be deducted in the year in which it occurs, does it not?

Mr. McHale: That's right your Honor.

The Court: So by definition in order to be deductible in 1948 it must be, in law, held to occur in 1948.

Mr. McHale: I raise that question for your Honor there.

The Court: As I understood this case when I had it on the motion to dismiss, it was that the plaintiff Earl Callan had elected to treat about half of this

loss as a loss in 1946 when he declined to contest the reduction in the verdict, wasn't it?

Mr. McHale: Yes, your Honor.

The Court: Well, that doesn't seem to be here now. You gentlemen have eliminated that by stipulation.

Mr. McHale: Yes, we have eliminated that by stipulation, your Honor. We have agreed to values. We have in effect agreed to drop that case. And that is why I made the motion to dismiss that case, and the other causes of action in this case——

The Court: Now, we have the situation of whether the loss was completed at a closed transaction was to be deductible in 1938, or whether the ordinary business care and prudence permitted the plaintiff Earl Callan to defer the deduction until after he had settled with the Flood Control District in 1948. Is that the situation?

Mr. McHale: Yes, your Honor.

The Court: Well, aren't those both jury questions now?

Mr. McHale: Well, I am moving that enough facts have been adduced to take it away from the jury, your Honor.

The Court: I will deny the motion; that is, the motion for a judgment of acquittal pursuant to Rule 41(b) made upon the close of the plaintiff's case; and the motion as renewed and made upon the close of all the evidence; having in mind that the defendant offers some evidence through the stipulation, as to the facts.

Now, gentlemen, I am not as far along on these

instructions as I expected to be by this time. My secretary is typing some of them.

Mr. McHale: Your Honor, I was wondering about—you said Rule 41. I also meant Rule 50. Am I correct? I want to be sure that I state all my proper grounds here.

The Court: Oh, yes. Well, your motion for directed verdict at the close of all the evidence. Your motion—I am sorry—is a proper motion either under 41(b) or for directed verdict under Rule 50, either upon the close of the opponent's evidence or upon the close of all the evidence.

So it will be deemed that you made both motions under both rules, and they are both denied. The motions will be deemed made upon the grounds stated, and denied.

Thursday, February 10, 1955; 11:40 a.m.

The Court: Is it stipulated, gentlemen, the jury have left the courtroom?

Mr. McHale: So stipulated, your Honor.

Mr. Miller: So stipulated.

The Court: Now, I have excused the jury pursuant to Rule 51 for the purpose of permitting either side to record their objections to the instructions given, or their exception to the refusal to give requested instructions.

The rule provides, as you know, that no party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects, and the grounds of his objections. Of course that, as I say, applies not only

to the instructions given, but to any refusal or failure to instruct.

Are there any exceptions or objections which the plaintiff wishes to take as to the instructions given, including Instruction 18, gentlemen, which I have not yet given as a formality.

Mr. Miller: No objection by the plaintiff, your Honor.

The Court: The defendant?

Mr. McHale: Yes, your Honor. With respect to the instructions, as I previously pointed out, the Government has consistently taken the position that the test is not as that set out by the court in the instructions. And this has been previously argued and briefed and decided by the court on a motion to dismiss.

The Government relies upon the case of the Highway Trailer case. I don't have the citation before me, but it is cited in your Honor's opinion, 116 Fed. Sup.

In that connection, I object——

The Court: Has the defendant requested instructions embodying the rule of the Highway Trailer case?

Mr. McHale: I believe so, your Honor.

The Court: Will you give us the citation for the record? I have it here if you don't have it.

Mr. McHale: I believe I have it here, your Honor. That's Commissioner vs. Highway Trailer Company, 72 Fed. 2d, 913.

The Court: That's a decision of what circuit?

Mr. McHale: Seventh Circuit, 1934; certiorari denied 293 U. S. 626.

The Court: The opinion on the motion to dismiss which you referred to, this court's opinion, is reported in 116 Fed. Sup. at 191.

Mr. McHale: Yes, your Honor. And the Commissioner vs. John Thatcher and Son, 76 Fed. 2d 900; which were embodied in some of the requested instructions which were not given, I believe.

And so with respect to the instructions that are given——

The Court: Does the defendant object to the failure and refusal of the court to give any of the requested instructions of the defendant which were omitted?

Mr. McHale: You want first the omitted instructions?

The Court: Yes.

Mr. McHale: Yes.

The Court: You might just specify them by number. I am familiar with your arguments on the matter. You will not need to repeat them. They will be deemed repeated, all the arguments you made on the motion to dismiss and heretofore during the trial of the case.

Mr. McHale: And also United States Treasury regulations 111, Section 2923.

The Court: You will not need to specify the grounds of your objections for failure of the court to charge on your theory of the proper standard to be applied here. But I think you might well specify the numbers of the instructions that the court re-

fused to give, the number of your requested instruction.

Mr. McHale: As to that issue, I think, your Honor, instructions 4 and 5.

The Court: That is, as to the Highway Trailer Company problem.

Mr. McHale: Yes, your Honor.

With respect to the second issue, the abandonment and use of the property as a residence, I request the court for the cases cited in the instructions prepared, that the court should give instructions 12, 13, 14, 15, 17, 18, 19 and 20.

The Court: I thought that 13A might meet your objection there. But you reserve your objection as to all of those, as to the failure of the court to give all of those instructions.

Mr. McHale: Yes, sir.

The Court: Now, does that complete your objections as to failure and refusal?

Mr. McHale: Yes, your Honor, as to failure and refusal.

The Court: Now, as to the instructions thus far given, do you have any objections?

Mr. McHale: Yes. Now, with respect to the instructions given, your Honor, the principal issue of that raised by the Highway Trailer case, to which I referred, I think is embodied in instruction 11, the sentence commencing line 8, that sentence, "The law permitted plaintiff Earl Callan nonetheless to delay claiming a tax deduction for the loss or pursuing his claim against the Flood Control District if to do so would be the exercise of ordinary business care and

prudence under all the surrounding circumstances."

The Court: You assign that as error?

Mr. McHale: Yes, sir, we do.

The Court: Because it is inconsistent with the rule of the Highway Trailer case?

Mr. McHale: Yes, your Honor.

The Court: Any others?

Mr. McHale: Yes, 11(A), your Honor; the first paragraph, and sub-parts 2, 3 and 4; on the same ground.

The Court: Very well. Any others?

Mr. McHale: And on the same ground, the first paragraph of instruction 12.

The Court: Very well. Any others?

Mr. McHale: Instruction 14, Your Honor; the fourth paragraph. This is on the abandonment issue, now. I believe that this is immaterial and irrelevant on the subject.

The Court: The third paragraph?

Mr. McHale: No, your Honor. It is the fourth paragraph, commencing line 13.

The Court: Of instruction 13?

Mr. McHale: 14, your Honor. I am sorry.

The Court: Yes. You made that suggestion earlier.

Mr. McHale: I made the same objection previously.

The Court: Yes. I have your point on that. Any others?

Mr. McHale: I object to the form of 13 in that I suggest instead Government's 12. I believe it is 12.

The Court: Very well.

Mr. McHale: That concludes it, your Honor.
The Court: That is all?
Mr. McHale: That is all, your Honor.
[Endorsed]: Filed July 1, 1955.

[Title of District Court and Causes 13357-13922.]

Thursday, February 10, 1955; 10:00 a.m.

The Court: You may open the argument, Mr. Miller, on behalf of the plaintiff.

Mr. Miller: Thank you, your Honor.

Well, now, ladies and gentlemen of the jury, we are going to try to make this brief, again, for you. I can't see your faces very clearly because I am a little nearsighted, so if I don't seem to be looking you squarely in the eye please understand.

We want to thank you for listening so attentively to our testimony in evidence. You have been a very attentive jury. We asked for a trial by jury in this case because we think that truth, common sense and simple justice support our case. All we ask of you is that you give your verdict on the basis of the facts as you saw them in the light of the evidence. We have tried to present this evidence as honestly and as straight forwardly as we could so that you could form your own unbiased opinion and independent judgment of the merits of our case, and we hope that you will feel as we do, that the evidence calls for a verdict in our favor. We want to ask you to please bear in mind that Mr. Callan didn't take anything away from the Government. He just wants to re-

cover back the money that he paid under protest which he feels was improperly assessed against him.

You have observed our witnesses, Mr. Callan, Mr. Vargo, Mr. Wright and Mr. Lee. You have heard them testify, and I think you will agree that they are truthful and honorable men and their testimony was worthy of belief. Their testimony wasn't always exact as to some of the details and dates, but I think you know from your own experience that you wouldn't expect them to recall minute details.

Now, basically, the fact is here that Mr. Callan sustained grievous damage when a flood occurred in 1938. He didn't cause the flood. It wasn't his fault that the flood occurred. And the only issue that is incurred here is whether he is entitled to deduct a loss arising out of that damage, to deduct that loss in the year when they finally determined there was actually a loss and what that loss amounted to. Basically, the issue here, as we see it, is whether under the facts and circumstances as they were known and could have been known with reasonable diligence to Mr. Callan in 1938 is did Mr. Callan in good faith reasonably believe that he had at least a reasonable chance of recovery on his damage against the Flood Control District and therefore acted with ordinary business care and prudence in concluding that his damage in the flood of 1938 did not then represent a closed and completed loss, because he might have felt that he probably would get his reimbursement for those damages in his action.

Now, let's look at what happened. You saw the pictures of the property before the flood and you

saw the pictures taken during the flood. You saw the river washing away those houses. And you saw how the properties were washed away in a matter of hours, and despite the testimony in the case that there were supposed to be flood protection works to prevent this very thing from happening.

You heard how Mr. Callan came home one evening on March 2, 1938 and found that properties on which he personally worked for years, properties of great value, had simply been washed away. I think you will agree that he suffered then and there a grievous injury through no fault of his own, an injury which the Flood Control Works were supposed to prevent.

Now, you heard the testimony of how Mr. Callan promptly consulted eminent and reputable attorneys, and people in the vicinity whose property was damaged also consulted attorneys. They did likewise. They hired reputable and competent engineers and paid them to make a study and prepare an engineering report to determine whether the Flood Control District was negligent in permitting the catastrophe to occur. You saw the documents in this courtroom. You heard Mr. Callan testify that he didn't hire his regular attorney, Mr. Harry McClean, to handle this case but instead he hired the firm of Hill, Morgan and Bledsoe, including Mr. Morgan and Judge McCarthy, because they were top rate specialists in this type of case. You heard the testimony that all these attorneys, including Mr. Henry Lee, who was the attorney for the house people and who acted in the same case in the joint

action, that all these attorneys did a great deal of work in the case, and how they conferred many times with the engineers and how Mr. Callan conferred many times, not only with the attorneys, but also with the engineers; and how at all times during the year 1938 the flood case attorneys had the firm conviction that they would recover on their suit; and the engineers verbally stated—and in their report stated both to Mr. Callan and to his attorneys—that the Flood Control District was negligent and the damage to Mr. Callan's property was caused by that negligence.

These attorneys and these engineers had nothing to do with Mr. Callan's taxes. They were doing a lot of work in this case. They were busy attorneys. And you know that attorneys don't have anything to sell except their time and ability. They couldn't get paid for all their time and work in the case unless they collected. They didn't have to take the case. You saw the letter which showed they did take the case and on what basis they took the case. And I am sure you will agree that they wouldn't have taken the case if in their own self interest, their independent judgment, looking at it from their own viewpoint, they had not believed that they were going to recover in the action.

Now, all these attorneys, Mr. Lee, Mr. Morgan, Mr. Hill, and Judge McCarthy told Mr. Callan that he would recover; and the engineers, Mr. Reagan and Mr. Bell told Mr. Callan he would recover. Now, if you were in Mr. Callan's position and you consulted experts on the subject and those experts had

nothing to gain by being wrong, wouldn't you have believed those experts? What else could you, as a person trying to get the best possible assistance in a matter of great importance to you, what else could you do in the exercise of business care and prudence except to do just what Mr. Callan did? You would consult the best experts you could find and be sure they have nothing to gain by being wrong.

Now, it's clear that Mr. Callan's attorneys in the flood case had nothing to gain by being wrong but they could lose a lot of valuable time. Actions speak louder than words. They acted their opinion because they did a lot of work in the case. You heard how Mr. Callan himself did a lot of work in the case, and he conferred numerous times with the attorneys, going over all the facts in the case. And he believed his attorneys and engineers that he would recover his damages.

Now, what happened after that? Mr. Callan and his attorneys diligently prosecuted the case. They were delayed in getting to trial by the County demurrers, but they did get to trial in 1946, and Mr. Callan won a substantial verdict of $80,000 from a jury. You are a jury. This was a jury just like yourselves; people like yourselves decided Mr. Callan was entitled to $80,000 in damages because the Flood Control District was negligent.

Now, it is true that the court finally granted a motion for a new trial, so they would have to try the case over. That is all they decided, that the case would be tried over again. And before they could try the case over again there was an appeal and the

principal trial attorney died. So they decided to settle the case at a reduced figure.

Doesn't this history show you that Mr. Callan did have a bona fide case and it was diligently pressed?

* * * * *

Mr. McHale: The undisputed facts, I think, are clear. The Government doesn't dispute at all that Mr. Callan had a very grievous loss in 1938 by reason of the flood. Whether it was the Act of God, an act of nature or whether there was some negligence on the part of the Los Angeles Flood Control District or whether it was the blame of some party or parties, that was a matter that was determined over across the street in the Superior Court.

The houses were two big houses, the one he lived in and the other one at 1723 Rancho, and they were completely washed away and destroyed. There is no doubt about that. We don't contest that. The amount of his damages were known to Mr. Callan in 1938.

The flood occurred on March 2nd. By the end of that year he had innumerable conferences with engineers and lawyers and he knew what his loss was. In fact, by the end of the year he filed a claim against the Los Angeles County Flood Control District for reimbursement because he thought—his advisors, lawyers and engineers, thought maybe that the Flood Control District was to blame for his houses being washed away, and he filed a claim. And before the end of the year, December 1938, before he filed his income tax return for 1938, the County denied that claim. The County Flood Control District said, "It is not our fault."

Mr. Callan had no insurance. In fact, he had no claim for reimbursement against anyone else. There was no contract; no contract of sale of the house or leasing or anything under which any other person would have been obligated in any way to pay Mr. Callan by reason of this loss. In other words, he had an unreimbursed loss. His only chance of recovery at the end of 1938 was to sue the Los Angeles Flood Control District. Mr. Callan did sue the Los Angeles Flood Control District.

We should look at this the way Mr. Callan looked at it in 1938, because to be frank in 1938 Mr. Callan didn't know what the progress of this thing was; how successful his suit would be. His lawyers took it on a contingency. Now, the attorney was called, the attorney for one of the parties in this suit, and stated that it is a common practice among lawyers in this community that negligence suits—and this is a negligence suit, a suit against the County for negligence—are handled on a contingency basis; that is how the lawyers handle these suits, they take a portion of the recovery that they get. In other words, they gamble on the thing. So they took, I believe the evidence showed, a 25 per cent contingency fee for this. And so the suit proceeded. And he sues this claim, which was known to him, the amount he had thoroughly investigated, and he knew what the property was worth and knew what he was suing the county for and his claim was for $220,000 some odd dollars and cents. His suit was finally determined in 1948. The final summation of the suit was settled, after a long and arduous proceeding through the

courts, for around $8400; less than four per cent of the amount he sued for. And you know that his damage was great. I mean, somewhere near the $220,000 figure.

So if we look at it from the point of view of hindsight we see that Mr. Callan's claim for reimbursement—and all it was was a cause of action or lawsuit—you have got a four per cent recovery by settling at the very end, which you might say was a nuisance settlement. At least, I think you can use your judgment and say that four per cent is not a very adequate recovery.

Now, you can take into account how Mr. Callan would have treated this, should have treated this on his 1938 income tax return as a reasonable and prudent man. Now, if Mr. Callan—and Mr. Callan, I think the facts show, is a reasonably wealthy man with several sources of income, and during these years he had considerable income—if a man has substantial income and he has a loss that he knows is definite and certain and can use that loss to offset his income, and he knows the amount of it—and there is no question that the houses had been destroyed in the year—as a reasonable and prudent man wouldn't he use that in the year in which the loss occurred? Or would he put it off until some future year until maybe he would recover something and maybe he wouldn't? If he puts it to a future year, if he recovers something, recovers the amount of his loss, why, he will never get a loss at all. But if he puts it over to a future year and he doesn't recover what he is suing for, he might get a loss. And he

doesn't know what his income will be in the future year and when that will occur. And when in 1938 he filed a tax return, his thought is, "What is my loss now?" Now, as a reasonable and prudent man, a man of business, shouldn't he deduct that loss in 1938? I think you will agree a reasonable and prudent man would do that.

Now, why didn't Mr. Callan deduct that loss in 1938? It is a stipulated fact, ladies and gentlemen of the jury, that Mr. Callan already had a loss in 1938. That is the reason why Mr. Callan didn't deduct it in 1938, we submit. But a reasonable man, a reasonable and prudent man would have taken that loss then because that is the standard that we use.

* * * * *

Mr. Miller: Ladies and gentlemen, I just want to reply as briefly as I can to some of the statements in Mr. McHale's argument which I think are perhaps incorrect, or perhaps misleading—not intentionally so.

Now, you heard Mr. McHale mention the fact that the claim had been denied by the City near the end of 1938, and, ladies and gentlemen,——

Mr. McHale: May I correct that? I think I said the County Flood Control District.

Mr. Miller: All right.

And you heard me ask Mr. Callan and Mr. Lee both what their opinion was of their prospects of recovery at the end of 1938, which was after this so-called denial of claims, and they both said emphatically that they had every expectation of making the recovery. So that this did not make any differ-

ence in the opinion of anyone of the merits of the case. It was merely a procedural formality which the law requires before a plaintiff can bring his court action against a governmental agency.

We filed a refund claim in this action in order to comply with the procedure for coming to court in this case.

Now, Mr. McHale mentions the fact that he states attorneys customarily handle negligence cases on a contingency basis. It is true that some negligence cases are handled on a contingency basis. But I think you, as reasonable people, will conclude that an attorney is not going to handle a case on a contingency unless he thinks he has a pretty good chance of recovery. And certainly you must believe that he has nothing to gain by being wrong about the case. If he takes it on a contingency he can lose. I should say he could gain nothing except experience, and he can lose a lot of time.

Now, Mr. McHale mentions the fact that the case was finally settled in 1948 for some $8000 odd dollars. Nevertheless, the fact remains that the jury, people like yourselves, heard all the evidence in the case and they decided the Flood Control District was ngligent and that Mr. Callan was entitled to recover $80,000. I think that speaks for the merits of the case.

Now, Mr. McHale has referred to the matter of whether a reasonable and prudent man would have deducted upon his 1938 return for this damage. Now, I want to ask you whether it is reasonable to conclude that this case was some kind of a tax maneuver

when Mr. Callan actually got a verdict of $80,000 in the case. And I would like to ask you whether there can be any doubt that his attorneys had a reasonable basis for their belief and advice to him in 1938 that he would recover.

I think the answer to those questions must be obvious, ladies and gentlemen; that this was a valid cause of action, a good claim for recovery, which Mr. Callan and his attorneys reasonably thought they would recover upon and which they did in fact make some recovery, and should have recovered a lot more but the chief trial counsel died before they could try it over again.

Now, Mr. McHale refers to the case of Mr. Callan and going in a high income bracket. Now, I think it is a matter of common knowledge that the brackets were a lot lower in 1938 than they are today. The taxes didn't really assume a very important part in the conduct of most people's business affairs. Mr. Callan's tax man told him, after the case had been instigated, had been filed in court, which was about February 1939, he went over to sign his tax return and Mr. Monroe, who had just prepared all these things and Mr. Callan simply signed them, said he couldn't take the loss because the suit for recovery had been filed and therefore he was not allowed to deduct that loss.

* * * * *

[Endorsed]: Filed July 11, 1955.

[Endorsed]: No. 14817. United States Court of Appeals for the Ninth Circuit. Robert Riddell, Collector of Internal Revenue, and Harry C. Westover, former Collector of Internal Revenue, Appellants, vs. Earl Callan and Helen W. Callan, Appellees. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: July 13, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14817

ROBERT RIDDELL and HARRY C. WESTOVER, Appellants,

vs.

EARL CALLAN and HELEN W. CALLAN, Appellees.

APPELLANTS' STATEMENT OF POINTS

Pursuant to the provisions of Rule 17(6) of the rules of the United States Court of Appeals for the Ninth Circuit, Appellants hereby adopt Appellants' Statement of Points to be Relied upon on Appeal, which was filed in the District Court, as their state-

ment of the points upon which they intend to rely in this Court.

Dated: This 15th day of July, 1955.

LAUGHLIN E. WATERS,
United States Attorney

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief, Tax Division

/s/ EDWARD R. McHALE,
Attorneys for Appellants

[Endorsed]: Filed July 16, 1955. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

APPELLANTS' DESIGNATION OF RECORD

Pursuant to Rule 17(6) of this Court, Appellants hereby designate the following parts of the record which Appellants believe necessary for consideration of the points upon which they intend to rely in this appeal, and which they desire to be printed, omitting the title of court and cause from each of the documents designated for printing unless otherwise directed (the page on which each document designated commences in the original certified record is shown in brackets):

1. Complaint [2];
2. Notice of Motion and Motion to Dismiss, filed October 1, 1952 [42];

3. Stipulation and Order Allowing Amendment of Complaint and Submitting the Motion to Dismiss on the Amended Complaint, filed October 27, 1952 [63];

4. Order on Motion to Dismiss, filed October 30, 1953 [66];

5. Answer to Amended Complaint, filed November 18, 1953 [88];

6. Stipulation of Facts, filed January 28, 1955 [Plaintiffs' Exhibit 33];

7. Stipulation of Issues to be Tried, filed January 28, 1955 [98];

8. Defendants' Request for Instructions 1 to 15, filed February 8, 1955, except omit from printing and consideration on appeal Instructions 12, 13, 14 and 15 [101];

9. Instructions to the Jury given February 10, 1955, filed February 10, 1955 [124];

10. Special Verdict, filed February 10, 1955 [151];

11. Judgment, filed and entered February 16, 1955 [156];

12. Motion for Judgment Notwithstanding Verdict to the Contrary, or in the Alternative, Motion for Partial New Trial, filed February 21, 1955 [160];

13. Order Denying Defendants' Motion for Judgment Notwithstanding Verdict to the Contrary, and Denying Defendants' Alternative Motion for Partial New Trial, filed March 7, 1955 [168];

14. Notice of Appeal, filed April 15, 1955 [171];

15. Motion for Extension of Time to Docket

Cause on Appeal and Order, filed May 20, 1955 [173];

16. Appellants' Designation of Contents of Record on Appeal (Dist. Ct.) [176].

17. Appellants' Statement of Points Upon Which They Intend to Rely on the Appeal [179];

18. Minutes of Court dated June 11, 1952 [38];

19. Minutes of Court dated October 13, 1952 [46];

20. Minutes of Court dated October 15, 1952 [60];

21. Minutes of Court dated September 28, 1953 [61];

22. Minutes of Court dated October 1, 1953 [62];

23. Minutes of Court dated February 8, 1955 [119];

24. Minutes of Court dated February 9, 1955 [120];

25. Minutes of Court dated February 10, 1955 [123];

26. Reporter's Partial Transcript of Proceedings, February 9 and 10, 1955, pages 1 to 14;

27. Reporter's Partial Transcript of Proceedings, February 9 and 10, 1955, pages 1 to 63, except omit from printing and consideration on appeal that portion thereof commencing line 7, page 20 through line 17, page 22, and from line 6, page 31, through line 4, page 42;

28. The following portions of the proceedings in case No. 13357-WM, Earl Callan, Plaintiff, vs. Harry C. Westover, Defendant, in which instances

Appellants desire the title of court and cause to be printed:

(a) Notice of Motion to Dismiss filed April 4, 1952 [32];

(b) Order on Defendant's Motion to Dismiss, filed September 18, 1952 [39];

(c) Stipulation and Order for Submitting Motion to Dismiss Amended Complaint on Memoranda Previously Filed [65];

(d) Memorandum of Decision filed October 30, 1953 [67];

(e) Stipulation and Order for Dismissal with Prejudice filed and entered February 16, 1955 [155];

29. Acknowledgment of receipt of service of Appellants' Designation of Contents of Record on Appeal, and Statement of Points to be Relied Upon on Appeal [183];

30. Stipulation Regarding Contents of Record on Appeal [184];

31. Certificate of Clerk;

32. Appellants' Statement of Points to be Relied Upon on Appeal (Court of Appeals);

33. Appellants' Designation of Parts of Record Necessary for Consideration on Appeal and to be Printed.

Dated: This 15th day of July, 1955.

LAUGHLIN E. WATERS,
United States Attorney
EDWARD R. McHALE,
Asst. U. S. Attorney, Chief,
Tax Division

/s/ EDWARD R. McHALE,
Attorneys for Appellants

[Endorsed]: Filed July 16, 1955. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

APPELLEE'S DESIGNATION OF RECORD

Pursuant to Rule 17(6) of this Court, Appellees hereby designate the following additional parts of the record which Appellees believe necessary for consideration of this appeal, and which they desire to be printed, omitting the title of court and cause from each of the documents designated for printing unless otherwise directed (the page on which each document designated commences in the original certified record is shown in parentheses):

1. Appellees' Designation of Contents of Record on Appeal, filed July 11, 1955, (Dist. Ct.) (p. 186).
2. Reporter's Partial Transcript of Proceedings February 10, 1955, pages 1 to 11, line 15, inclusive, and pages 13 to 15, line 16, inclusive.
3. Appellees' Designation of Parts of Record Necessary for Consideration on Appeal and to be printed.

Dated: This 20th day of July, 1955.

/s/ HERBERT S. MILLER,
Attorney for Appellees